A Guide to DST 1031 Best Practices (2022)

As of November 2022

ADISA Guide to DST 1031 Exchange Best Practices

This ADISA Alert is a guide to certain best practices relating to DSTs which are intended to qualify under Section 1031 of the Internal Revenue Code of 1986, as amended ("Section 1031") and are sold through financial advisors.

LIKELY INTERESTED GROUPS

- Sponsors
- Broker-Dealers
- Registered Representatives
- Investment Advisors
- Attorneys, CPAs, and other Professional Advisors
- Qualified Intermediaries
- Investors

THESE BEST PRACTICES WERE CREATED THROUGH A COOPERATIVE EFFORT BETWEEN INDUSTRY PARTICIPANTS INCLUDING FINANCIAL ADVISORS, SPONSORS, ATTORNEYS AND ADISA COMMITTEES.

ADISA PUBLICATION DATE

July 18, 2022

This ADISA White Paper is provided by ADISA for educational and informational purposes only and is not intended, and should not be construed, as legal or investment advice. This ADISA White Paper is not a statement of substantive law. Persons or entities are urged to consult their own legal counsel should they seek advice regarding the matters discussed herein.

Neither ADISA, nor any of its directors, officers, employees or agents, makes any representation of warranties, express or implied, or assumes any legal responsibility for any information on the list itself or information provided by those listed in the product/services directory. Inclusion in the product/services directory and access to view the product/services directory are part of ADISA's member benefits and does not necessarily express or reflect opinions of, nor constitute an endorsement or recommendation by ADISA, nor any of its directors, officers, employees or agents.

Copyright © 2022 by ADISA. All rights reserved
Readers may copy section of this publication for personal use. However, it is a violation of U.S. copyright laws to copy substantial portions of the publication for any other reason without permission. The Copyright Act of 1976 provides for damages for illegal copying. If you wish to copy and distribute sections of this publication, please contact ADISA headquarters at adisa@adisa.org .

Pursuant to requirements relating to practice before the Internal Revenue Service, nothing in this publication is intended to be used, and cannot be used, for the purpose of (i) avoiding penalties imposed under the United State Internal Revenue Code, or (ii) promoting, marketing, or recommending to another person any tax-related matter.

Table of Contents

PART I. HISTORY AND FOUNDING PRINCIPLES ... 2

PART II. LIKEKIND EXCHANGES ... 2
- A. In General ... 2
- B. Deferred Exchanges ... 3
- C. Gain/Boot Rules ... 4

PART III. DELAWARE STATUTORY TRUSTS ... 4
- A. In General ... 4
- B. DST Restrictions ... 5
- C. DST Benefits ... 5
- D. DST Structures ... 6
  - Triple Net Lease ... 6
  - Master Lease ... 6
- E. Master Lease Structures ... 6
  - Fixed Rent ... 6
  - Participating Rent ... 6
- F. Lender Issues ... 7
- G. Section 721 DSTs ... 8

PART IV. PRIVATE PLACEMENT MEMORANDUMS AND DISCLOSURE ... 9
- A. In General ... 9
- B. Special Disclosure Issues ... 10
  - Bridge Financing ... 10
  - Sponsor ... 10
  - Prior Performance ... 10
  - Property-Level Cash Reserves ... 10
  - Tenant Lease Disclosures ... 11
  - Master Lease ... 11
  - Third-Party Reports ... 11
  - Tax Opinions ... 11
  - Fee Disclosure ... 12

PART V. DUE DILIGENCE ... 12
- A. In General ... 12
- B. Due Diligence Package ... 12
- C. Sponsors ... 13
- D. Third-Party Due Diligence Reports ... 14

PART VI. DST SECURITIES PRACTICES ... 14
- A. Suitability ... 14
- B. Broker-Dealer Supervision of Registered Representatives ... 15
- C. Contemplation Rule ... 16
- D. Pre-existing Relationships ... 16
- E. General Solicitation ... 16
- F. Sales Materials & Marketing Rules ... 17
- G. Timing of Information Flow for New Offerings ... 18
  - Sponsor Evaluation Period ... 18
  - Contemplation Period ... 18
  - Financial Advisor Due Diligence Cooling Off Period ... 18
  - Marketing Cooling Off Period ... 19
  - Order Acceptance Period ... 19
- H. Subscription Paperwork and Recordkeeping ... 19
- I. Post-Closing Items ... 19
  - Filings & Agreements ... 19
  - Closing Documents ... 20
  - Investor Communications ... 20
  - Financial Reports & Audits ... 20

ADISA Guide to Best Practices for DSTs Designed for Section 1031 Exchanges

PART I. HISTORY & FOUNDATION PRINCIPLES

The distribution of tenant in common ("TIC") interests through broker-dealers and investment advisors ("financial advisors") began to accelerate in the latter part of the 1990s. The original purpose of the TIC structure was to allow investors to invest smaller amounts in institutional-quality real estate which they could not invest in on their own. The early offerings of TIC interests relied on tax opinions because there was no direct guidance from the Internal Revenue Service ("IRS").

In the early 2000s, as a result of the hesitancy of some of the financial advisors to sell TIC investments without additional IRS guidance, attorneys for certain providers of tenant in common interests ("sponsors") worked with the IRS to create guidelines that would establish the requirements necessary for TIC interests to qualify as real estate and not as an interest in a business entity. As real estate for income tax proposes, TIC interests could qualify as replacement property under Section 1031. This resulted in the issuance of Revenue Procedure 2002-22 ("Rev. Proc. 2002-22"). In 2004, the options available to investors were further expanded when Revenue Ruling 2004-86 ("Rev. Rul. 2004-86"), was issued. Rev. Rul. 2004-86 set forth requirements for a DST to qualify as replacement property under Section 1031. Following the issuance of Rev. Proc. 2002-22 and Rev. Rul. 2004-86, sales of Section 1031 eligible securities grew from about $375 million and $750 million in 2002 and 2003, respectively, to $3.65 billion in 2006.[1]

The use of the TIC structure became limited because lenders realized that the unanimous consent requirements made it difficult for lenders to work with TIC borrowers, especially with defaulted loans. As a result, the use of the DST structure became more prominent.

ADISA first published its Guide to certain TIC Best Practices in March 2006 when the TIC structure was the dominant structure. ADISA has been committed to developing best practices to better serve the needs of investors. Equity raised through DSTs is at an all-time high suggesting a greater need for standardized procedures and best practices. Through a collaborative effort with industry participants ADISA is issuing this ADISA Guide to Best Practices for DSTs Designed for Section 1031 Exchanges (this "DST Guide"). This DST Guide addresses the sale of DST beneficial interests by sponsors through financial advisors. The practices recommended by this Guide were developed within the current framework of applicable securities laws and regulations and industry practice. Just as the industry has evolved since its origination, so have the needs of the industry.

The DST Guide should not be construed as legal advice, legal interpretation or written policies for the financial advisors or sponsors. Firms are urged to consult their own legal counsel regarding the matters discussed herein.

PART II. LIKEKIND EXCHANGES

A. In General

Section 1031 allows an owner of real estate to exchange real estate used in a trade or business or held for investment for like-kind property on a tax-free basis. This can be done as a direct exchange or through the sale of the real property and the acquisition of replacement property pursuant to a deferred exchange.

1 2—Mountain Dell Consulting

IRC §1031(a)(1) states:

"No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment, if such property is exchanged solely for property of like-kind which is to be held either for productive use in a trade or business or for investment."

To understand the opportunity offered under Section 1031, consider the following example:

- Assume an investor owns real estate with a $0 tax basis that the investor sells for $250,000. This would result in $250,000 of realized gain by the investor. Assuming a 35% net tax rate (depreciation recapture, federal capital gain tax, state capital gain tax and net remaining investment income tax) the investor would have $162,500 remaining after the taxes were paid. Assuming the investor can obtain a 5% return on the next investment, the investor would receive a return of $8,125 per year ($162,500 x .05).
- If the same investor elected to utilize a Section 1031 exchange, the investor would be able to reinvest the entire $250,000 received from the sale. Assuming the investor can also receive a 5% return on the replacement property, the investor would receive a return of $12,500 per year ($250,000 x .05).

One of the requirements for a Section 1031 exchange is that the replacement real estate must be "likekind" to the exchanged property. This is now limited to the exchange of real estate for real estate. Real estate has generally been interpreted as property recognized as real estate under state law. Thus, no distinction is made between improved or unimproved real estate. Consequently, farmland can be exchanged for an office building or a storage facility can be exchanged for a factory. The like-kind rules also extend beyond traditional fee-simple interests to include long-term leasehold interests in real property, perpetual water rights and oil and gas mineral rights.

B. Deferred Exchanges

Section 1031 requires that the replacement property be acquired through an exchange of properties, rather than a sale and subsequent purchase. Thus, a taxpayer who is a seller of real estate cannot directly or constructively receive cash in a transaction and then use the cash to purchase replacement property.

In a direct exchange, the Section 1031 requirements are met because there is a direct exchange of properties. However, it is difficult in most cases to match suitable buyers and sellers for a direct exchange. For this reason, most Section 1031 exchanges are conducted as deferred exchanges.

In a deferred exchange a qualified intermediary (the "QI") acts as the assigned-in buyer and seller. The taxpayer seeking like-kind treatment will enter into the sale agreement with the buyer of the property and assign the property and the sale agreement to the QI. The QI will then complete the sale transaction with the buyer of the relinquished property. The taxpayer will identify the replacement property and enter into a purchase agreement with the seller of the replacement property. The taxpayer will then assign the purchase agreement to the QI and the QI will acquire the replacement property and transfer it to the taxpayer.

If the Section 1031 requirements are complied with including (i) identifying replacement property within 45 days of the transfer of the relinquished property, (ii) transacting through a QI (if a deferred exchange) and (iii) acquiring the replacement property within 180 days of the transfer of the relinquished property, gain on the exchange can be deferred.

It is important to ensure that the QI is qualified to serve as the accommodator. A comprehensive list of persons who are disqualified from serving as intermediaries is set forth in Treasury Regulation §1.1031(k)-1(k). Among those disqualified

from serving as an exchange intermediary are agents of the taxpayer, such as employees, attorneys, investment bankers, accountants and real estate agents and brokers.

There are several methods for identifying replacement property. If a DST has multiple properties the identification of the DST as replacement property is not treated as one identification if the three property identification rule is used.

C. Gain/Boot Rules

The underlying policy of Section 1031 is to allow the deferral of income in cases where a taxpayer has maintained a continuous investment in likekind property. Thus, a taxpayer should not be required to recognize gain in cases where the taxpayer has maintained a continuous and ongoing investment in likekind property where there has not been a "cashing out" of the investment. Generally, if a taxpayer receives non-like-kind property, the taxpayer will recognize gain equal to the lesser of (i) the value of the non-like-kind property received in the Section 1031 exchange and (ii) the amount of the taxpayer's realized gain. Special rules apply to the relief and the assumption of indebtedness. Non-like-kind property received in a Section 1031 exchange is commonly referred to as "boot."

There are three typical ways boot is created.

- Cash is received by the taxpayer in the exchange.
- The taxpayer receives non-like-kind property.
- The taxpayer has mortgage boot. Mortgage boot is the amount the indebtedness on the relinquished property exceeds; (i) the indebtedness on the replacement property plus (ii) any additional cash invested by the taxpayer.

Mortgage debt is typically present on both sides of a Section 1031 exchange. If a mortgage is assumed in a Section 1031 exchange, the mortgage will be treated as part of the amount received. If a mortgage is paid off as part of the transaction the seller is still required to treat the cash used to repay the mortgage as received in the transaction.

There is a very simple test to determine if there is any boot:

- The taxpayer must acquire property of equal or greater value and must not receive any cash or other non-like-kind property.

It is important for financial advisers to understand the amount of the liabilities on the relinquished property to acquire replacement property with leverage necessary to avoid boot.

Certain sponsors utilize a "cash-out" DST which distributes cash from refinancing proceeds after the investors are admitted into the DST. There are significant differences of opinion with respect to the viability of cash-out DSTs. We recommend extreme caution, and potential avoidance, with respect to the acquisition of an interest in a cash-out DST. Any investor in a cash-out DST should be sufficiently sophisticated to understand the risks and the tax opinion should be clear and thorough, and directly provide an opinion on the likelihood of success of the structure and the risks of failure.

PART III. DELAWARE STATUTORY TRUSTS

A. In General

The DST structure eliminated the primary deficiency of the TIC structure-unanimous consent. As a result, the DST structure is generally preferred by lenders and has become the structure of choice in the industry. A DST is a separate legal entity created under Delaware statutory law. If Rev. Rul. 2004-86 is complied with (i) the DST will be classified as a trust rather than a partnership for purposes of Section 1031 and (ii) each beneficial interest owner will be treated as

owning an undivided interest in each asset that is held by the DST.

Trusts are generally controlled by trustees. The following trustees are present in a DST structure:

- A manager/signatory trustee is the primary individual or entity appointed to manage the DST. The sponsor typically appoints an affiliate as the manager/signatory trustee.
- Depending on the lender, a DST may also have an independent trustee. An independent trustee typically serves to protect the interests of the lender and generally can only vote on a determination by the DST to file for bankruptcy.
- A DST must have a Delaware trustee under Delaware law. The Delaware trustee does not have any managerial power.

The beneficial interest holders should not have any power or voting rights. In addition, the DST can only have one class of ownership which means there can be no special allocations and every owner must receive the same returns.

B. DST Restrictions

The key to qualifying as an investment trust and not a business trust is that the trustee must not have the power under the DST trust agreement "to vary the investment" of the beneficial interest holders. It is not sufficient to simply include a provision in the DST trust agreement, the requirement also needs to be complied with.

While Rev. Rul. 2004-86 confirmed that beneficial interests in a DST may qualify as replacement property in a Section 1031 exchange if properly structured, Rev. Rul. 2004-86 imposes significant restrictions, commonly referred to as the "seven deadly sins." The trustee of the DST cannot take, and cannot even have the power, to take any of the following:

- Accept additional contributions of property or cash;
- Renegotiate or refinance the terms of any loan used to acquire the real estate;
- Enter into any new lease or renegotiate any existing lease, except if a tenant is bankrupt or insolvent;
- Sell the real estate and use the proceeds to acquire new real estate;
- Make modifications other than minor non-structural modifications unless required by law;
- Purchase assets other than short-term investments. Any short-term investments must be limited to short-term obligations of the United States, or any agent or instrumentality thereof, and certificates of deposit of a bank or trust company, and must mature prior to the next distribution date. The trustee is required to hold such obligations until maturity.
- The trustee must distribute all cash, other than necessary reserves, on a current basis as defined by the terms of the DST trust agreement.

Caution is advised if a DST holds reserves for future distributions.

C. DST Benefits

The DST structure offers the following benefits over a TIC structure.

- The investor is not required to create its own special purpose entity. Instead, the investor will own a beneficial interest in the DST. This avoids the complexity of each investor forming and maintaining its own special purpose entity to hold its interest in the property.
- The structure is not subject to the decisions of other investors.
- The lender will underwrite the property and does not have to underwrite each investor.

- In some cases lenders may be able to offer more favorable loan terms than for a comparable TIC structure.

Further, the investor does not have personal liability on the nonrecourse carveouts.

- The DST can have up to 2,000 investors which is significantly greater than the 35 investor TIC limit. This allows smaller investments and greater diversification.
- Management decisions are made exclusively by the manager/signatory trustee. Thus, the threat of a holdout or rogue investor is eliminated.
- A separate deed is not required to transfer the property.
- It is easier to invest into multiple DSTs for both diversification and to solve mortgage boot issues.

D. DST Structures

Triple Net Lease.

Many of the DSTs involve the acquisition of triple-net lease properties. In this structure, properties subject to longterm triple net leases with credit tenants are acquired and the properties subject to the longterm leases are held and operated by the DST.

Master Lease

A DST is not allowed to release a property, except in the case of a tenant's bankruptcy or insolvency. Consequently, DSTs that own real estate that will be required to be re-leased are structured with a master lease. The master tenant leases the property from the DST. The master tenant is typically an affiliate of the sponsor and subleases the property to the ultimate end users. The master tenant handles property-level maintenance and repairs, and typically contracts with a property manager (which also may be an affiliate of the sponsor). A master lease avoids the prohibition on re-leasing the property and keeps the DST from operating a trade or business.

- The master tenant or its affiliates should not own any of the DST (See Rev. Rule 2004-86). Thus, a sponsor of an affiliate should not retain an interest in the DST if the sponsor or an affiliate is the master tenant.

E. Master Lease Structures

There are two basic master lease structures; those with fixed rent and those with participating rent.

Fixed Rent

In a fixed rent structure, the master tenant is required to pay a fixed amount to the DST and pay all of the property's operating expenses. In a master lease structure, it is possible to have either the master tenant or the DST responsible economically for real estate taxes and insurance.

Participating Rent

In a participating rent structure, the master tenant typically pays a fixed amount and then pays an additional amount based on a percentage of gross revenue. The participation is often a share of gross revenues in excess of a baseline amount. This can only be a share of gross revenue and there cannot be a sharing of net income.

We recommend that the following structures be thoroughly reviewed, and potentially avoided, prior to any decision to proceed with a recommendation of the offering. The offering material should clearly discuss the risks of these structures and the tax opinion should specifically discuss the issue and opine on the issue:

- Similar gross rent participation provisions in the Internal Revenue Code provide that the share of gross income cannot be an attempt to actually share in net income. (See Treasury Regulation Section 1.8564(b)(3)). If there are multiple rent adjustments to reflect changes in expenses or net income the IRS might view it as an attempt to share net income.
- Adjustments in the participation calculation based on operating expenses or costs should be closely reviewed and avoided. This was confirmed by the IRS in PLR 202205001 (Feb. 4, 2022).
- There should not be any splitting of proceeds from the sale of the property in the DST.
- In the event there is a conditional disposition fee the threshold should be based on a fixed dollar amount received from the sale of the property. It should not be based on a return of capital or minimum returns to the investors.
- Master leases should not base rent on the cash flow from the property held by the DST. The master lease is required to be a true lease for income tax purposes and a cash flow lease does not qualify.

The master tenant should be adequately capitalized. Sponsors typically capitalize the master tenant with an unsecured promissory note. The entity contributing the promissory note should have sufficient net worth to pay off the note if it is drawn upon. The promissory note can also be guaranteed by a person or entity with sufficient net worth. The minimum promissory note is typically the lesser of 6 months of gross rent or $500,000.

We recommend the following structures be thoroughly reviewed and potentially avoided.

- Master leases that allow the master tenant to make more than minor nonstructural improvements including but not limited to improving the property. (See PLR 6501275170A (January 27, 1965)).
- Master tenants with no economic substance or that allow for deferral of rent payments so that there is no actual ability to pay rent except from cash flow.

It is important that the master lease contain, and the PPM disclose, unambiguous language regarding whether the master tenant or the DST has responsibility for expenses and obligations. This is especially true with respect to capital expenditures.

- Structures without clear differentiation as to the responsible party for expenses and obligations should be avoided.

F. Lender Issues

In many cases the DST borrows money from a lender. The loan agreements of many lenders include provisions that can cause a DST to fail to qualify as an investment trust. The primary area of concern occurs with master lease structures. The typical structure is a back-to-back pledge. The master tenant pledges its assets to the DST as security for payments under the master lease and the DST pledges the assets to the lender as security for the loan. It is difficult for financial advisors to review and determine the provisions in the loan documents. Thus, it is imperative that the potential loan document issues are discussed in the offering materials and covered by the tax opinion.

The following structures should be avoided:

- The master tenant and the sponsor should not sign as co-borrowers.
- The lender should not be able to obtain more funds from the master tenant than the master tenant owes under the master lease.
- Lenders that require modifications to the master lease can impact the “true lease” requirement of the master lease.

This includes provisions that allow the lender/landlord to exercise remedies against the master tenant even though the master tenant has not defaulted.

- The lender should not be able to obtain income from the property while the master lease is in effect.
- The lender should not be able to invest the DSTs funds in violation of Rev. Rul. 2004-86.
- The sponsor should not be a lender or guaranty the loan (except for nonrecourse carveouts).
- The loan documents should not include cross defaults or cross guarantees with other sponsor projects or DSTs.

Although not a legal issue it is also preferable to avoid loans where the lender has the right to require the DST to spring into a limited liability company or the right to prevent the DST from springing into a limited liability company. This can prevent the DST from solving a problem with the real property or cause the beneficial interest holders to lose their right to do a Section 1031 exchange.

G. Section 721 DSTs

There has recently been an increase in the number of DST offerings that allow the sponsor to exercise an option to acquire the beneficial interest in the DST held by the investors after a specified period of time. These transactions are typically structured so that the acquisition can be accomplished tax-free under Section 721. In order to be tax-free the investor would need to receive partnership interest in exchange for the beneficial interest in the DST. One of the interesting elements is that not all of the options specifically identify the entity that will potentially exercise the option. Others specifically provide the option only to a specific operating partnership of a REIT.

There are two basic structures. The first structure allows the investor to determine whether the investor will receive cash or a partnership interest. The second allows the operating partnership to make a determination as to whether the operating partnership will provide the investor with cash or a partnership interest in the exchange.

In the event that a specific operating partnership is not identified to hold the option it should be the investor's choice as to whether cash or a partnership interest is received so that the investor is not required to take an interest in an operating partnership that was not identified when the investor acquired the beneficial interest in the DST.

In the event a forced roll up structure is utilized the financial advisor should make sure that the investor is fully informed that the holder of the option makes the decision as to whether the investor receives cash on a partnership interest. A forced roll up structure is typically utilized by investors who are comfortable with a REIT or partnership and are looking to diversify their holdings. The option should not be assignable in a forced roll up structure.

In the event the investor selects cash the investor can typically participate in a Section 1031 exchange upon the sale of the beneficial interest in the DST.

There are other concerns that have to be considered when selecting a rollup option whether mandatory or optional. When an investor contributes property with built-in gain to a partnership that built-in gain follows the contributing partner. Thus, if the operating partnership after a rollup sells the contributed property in a non-Section 1031 exchange the contributing partner would be required to recognize gain to the extent of the built-in gain at the time of contribution. In addition, a partner must maintain sufficient debt so that the partner is not required to recognize gain if the partner's share of debt decreases. Some roll up transactions provide investors with certain protections against the recognition of the built-in gain and the ability to guarantee additional debt to avoid having to recognize taxable income because of insufficient tax basis. In others, these issues are left to the discretion of the operating partnership.

The option of the operating partnership to acquire the beneficial interest in the DST from the investors typically begins two years after the last investors acquired their beneficial interests in the DST. This limitation is included so that the investors will not potentially lose their tax-deferred Section 1031 exchange treatment on the initial acquisition of the DST interest. Financial advisors should closely review the tax opinion issued with these transactions. Some opinions include a provision that indicates that it is tax counsel's opinion that the option will not affect the prior Section 1031 transaction and other tax opinions exclude this opinion.

One additional issue with respect to these transactions is the appraisal process. It is important for the financial advisors to understand how the properties will be valued at the time of exercise of the option. Some of the options provide that the property will be valued based on the value of the property subject to the existing leases (but excluding the master lease) and other options provide that the property will be valued based on the property subject to the master lease. These two options can provide different valuations of the property at the time of rollup.

Part IV. PRIVATE PLACEMENT MEMORANDUMS AND DISCLOSURE

A. In General

DST offerings are typically marketed to accredited investors in reliance upon an exemption from registration provided by Rule 506 of Regulation D.[2] As part of the sale of the DST interests, a Private Placement Memorandum ("PPM") providing full and fair disclosure of all material aspects of the offering and the material risks should be delivered. The PPM's content should include the following items as well as any other material information:

- Who may invest (containing the accredited investor criteria of Rule 501 of Regulation D);
- Offering summary;
- Risk factors;
- Sources and uses of proceeds in tabular form;
- Description of the real estate, lease(s), and key tenants;
- Terms of acquisition and financing;
- Summary of key documents (the DST trust agreement, all leases including the master lease and any sub-leases, the purchase agreement and any other material agreements);
- Description of the sponsor, material affiliates and their executives;
- Compensation paid to the sponsor and/or its affiliates (presented in a column or tabular format by type of compensation, method of compensation and amounts);
- Plan of distribution (explaining (i) the sales compensation items payable to the selling group and (ii) the terms of any discounts that may be given to certain investors based upon their subscription size or their relationship to the sponsor, its affiliates or the selling group);
- Conflicts of interest (including the terms and conditions of any material business transactions undertaken between the DST and the sponsor or its affiliates);
- Restrictions upon transferability;
- Federal and state tax considerations including a tax opinion; and
- ERISA implications

2—There are other exemptions that may be available but the other exemptions are not typically used for DST offerings.

B. Special Disclosure Issues

We recommend enhanced disclosure of the following items in the PPM:

Bridge Financing

It is common for DST sponsors to use bridge financing to acquire the real estate for a DST. The material risks of bridge financing that could have an effect on the DST, the investment or the investors must be disclosed in the PPM. The security for any bridge financing and the possible effects on the DST and the investors if there is a default on the bridge loan must also be disclosed. Bridge Financing should not be at the DST level and the DST should not pay the bridge financing. The bridge financing should be at the depositor level or above. A description and cost of the bridge financing should be discussed in the PPM, including but not limited to all remedies of the bridge lender.

Offerings that include bridge financing should be avoided if either (i) the assets owned by the DST are pledged to the bridge lender or (ii) the sponsor pledges directly or indirectly the trust manager or the master tenant such that upon a default of the bridge loan the bridge lender can take control of the DST or the master tenant.

The DST sponsor's process for retiring the debt should be considered during due diligence. Sponsors should generally acquire the property before syndication of the DST.

Sponsor

Any material weakness of the sponsor, its principals or its affiliate should also be prominently disclosed to investors within the PPM.

Prior Performance

Material information concerning the financial performance of all full cycle and currently operating offerings should be included in the PPM. Such performance information should be presented in tabular format for currently operating and fully completed programs with similar investment objectives to those of the current offering if they were offered during the ten-year period prior to the date of the PPM. Sponsors and their legal counsel should carefully review the investment objectives of prior real estate programs to determine if those programs share similar investment objectives with the current offering. In the absence of a sufficient number of similar programs, it may be advisable to use all prior programs of the sponsor in discussing prior performance. It is important to determine what is relevant prior performance. The prior performance related to a principal where the principal did not control the investment decisions should not be disclosed and the poor prior performance that a principal actually controlled should be disclosed.

Property-Level Cash Reserves

DST offerings usually include property-level reserves collected from loan proceeds, offering proceeds, or both, as the DST cannot raise additional capital from investors once an interest in the DST is sold. Reserves funded from loan proceeds may be controlled by the lender or the DST. The reserves collected from offering proceeds may include "accountable" reserves such as (i) capital expense reserves to be utilized for property and amenity renovations and other property-related costs and expenses, (ii) reserves for interest, insurance and taxes and (iii) general trust reserves (which should not be used to supplement cash flow to investors). Rev. Rul. 2004-86 indicates that the trustee may establish a reasonable reserve for expenses associated with the property and that the trustee must distribute all available cash other than the reserves.

- Structures that require DST reserves to be distributed in order to meet investors' projected return should clearly disclose such fact and should be avoided.

Tenant Lease Disclosures

PPMs should include a narrative or tabular summary of all leases supporting the master lease. For all material leases (including all leases of more than 10% of the overall property's square footage or revenue), detailed lease abstracts should be included in the PPM. Full copies of all leases should be available upon request to all parties. In addition, if a material tenant is a public reporting entity, the most recent 10-Q and 10-K for the tenant, including financial statements, either should be provided with the PPM or the PPM should provide a clear explanation of how to access the documents on the Securities and Exchange Commission's EDGAR website (although any such public data would not be part of the PPM).

Any discussion in the PPM regarding tenants should describe the legal entities that are actually the lessees under the leases. A description of a corporate parent company of the lessee should explain whether the parent is obligated under the lease entered into by the subsidiary.

Master Lease

The PPM should provide an explanation of the master lease and master tenant involved with the DST properties. The PPM should include a thorough summary of the master lease, including but not limited to (i) which party has responsibility for costs, expenses and capital improvements, (ii) allocation of costs and expenses between the master tenant and the DST, (iii) lease term, (iv) base rent, (v) how participating rent is calculated, and (vi) any other material terms. In addition, the capitalization of the master tenant should be disclosed in the PPM. If the master tenant does not have sufficient net worth the obligation to fund the master tenant should be from, or guaranteed by, a financially responsible party. A copy of the master lease should be included as an exhibit to the PPM.

Third-Party Reports

Appropriate thirdparty reports should be obtained and discussed in the PPM. This includes, but is not limited to (i) an appraisal, (ii) environmental report (phase 1 and phase 2, if necessary), (iii) property condition report and (iv) title and survey. Such reports should also be available to investors upon request. Appraisals should be prepared by appraisers that are certified to prepare such appraisal in the state where the applicable property is located and should be prepared by certified appraisers that are not affiliated with the DST sponsor or its affiliates.

All thirdparty reports should be directed to the DST or specifically include reliance language by the DST. If the thirdparty reports significantly limit the liability of the provider this should be disclosed in the PPM. Specific disclosure should be made if the thirdparty reports cannot be relied upon by the DST and the associated risks. Thirdparty reports should not be included in the PPM if their use in the PPM is prohibited by the provider.

In the event that a cost segregation study is part of the Offering, the details should be disclosed so that investors and financial advisors can understand the implications.

Tax Opinions

Pursuant to the Notice to Members 05-18, a sponsor should obtain a "should" or "will" tax opinion that the DST's interests qualify as real estate under Section 1031. If a sponsor obtains a "more likely than not" opinion, that would be a material fact to be considered in recommending that offering to a client. In such case the financial advisor should determine the risks and inform the investor of the risks.

If a “more likely than not” opinion is obtained, the specific reasons for not obtaining a “should” or “will” level tax opinion should be stated in the PPM. In either case, the tax opinion should be included as an attachment to the PPM. To enhance disclosure of tax issues and provide a complete analysis, tax counsel should provide a “long-form”/fully reasoned tax opinions that may be relied upon by the investors and should be in compliance with Circular 230. A copy of any factual certificate that is being relied upon by counsel should be included in the PPM. The tax opinion should affirmatively indicate that the loan documents were reviewed and that the loan documents will not impact the opinion.

- Opinions from employees or affiliates of a sponsor should be avoided.
- PPMs should not be approved to be distributed to investors unless an opinion is included.

Fee Disclosure

The PPM should clearly and thoroughly describe all fees, costs, offering expenses and selling commissions with regard to the sale of the DST interests and all fees paid from the DST or costs required to be reimbursed by the DST.

Special situations that should be disclosed include:

- Fees for compensation received other than from the DST. For example, the receipt of real estate commission on the transaction.
- Compensation paid to wholesalers who are internal to the sponsor.

PART V. DUE DILIGENCE

A. In General

FINRA and applicable securities laws require broker-dealers to perform an appropriate level of due diligence for every offering. See Regulatory Notice 1022. RIAs have similar duties as part of their fiduciary duty. Broker-dealers may not rely solely upon the accuracy of information supplied by the sponsor but must engage in an independent due diligence investigation customized for each offering. DST offerings may have certain unique features that require additional due diligence. This requires due diligence on service providers as well. In addition, the nature and extent of due diligence required will vary with the circumstances of each sponsor and offering. Members should make a reasonable investigation to ensure that the PPM does not contain false or misleading information. Such an investigation should include background checks of the sponsor’s principals, reviews of key agreements (property management, purchase/sale, leases, and loan agreements), and a property inspection. In addition, if the PPM contains projections, the financial advisor should understand the basis and assumptions for those projections, and the likelihood that they will occur. Financial advisors should determine whether projected yields can reasonably be supported by the property’s operations.

B. Due Diligence Package

Sponsors should provide a due diligence package to financial advisors and their due diligence professionals. This package should provide sufficient information to allow the financial advisors to review documents necessary in order to carry out its due diligence obligations.

Due diligence materials should be provided in PDF form and watermarked appropriately. Due diligence professionals should never forward due diligence links or documents to anyone that is not approved by the sponsor to preserve the integrity of the offering and protect proprietary information of the sponsor. Typical items in a due diligence package include:

- **PPM and Exhibits & Attachments**
  - PPM
  - Asset Management Agreement
  - Escrow Agreement
  - Managing and Selling Broker-Dealer Agreements
  - DST Trust Agreement
  - Master Lease Agreement
  - Property Management Agreement
  - Purchase Agreement
  - Tax Opinion
  - Title Commitment
  - Subscription Agreement & Questionnaire
- **Property Due Diligence**
  - Sponsor's Pro Forma Forecast
  - Rent Roll and copies of all leases on non-residential properties
  - 2-Year Historical Operating Financials (if available)
  - Loan Documents
    - Loan Agreement/Note for Primary Financing
    - Loan Agreement/Note or Preferred Equity for Mezzanine Financing (of Sponsor or Depositor)
  - Property Reports (including relative language)
    - Market Research
    - Demographic Report
    - Third-Party Appraisal
    - Phase I Environmental Assessment
    - Property Conditions Assessment
    - Zoning Letter/Opinion
    - ALTA/NSPS Survey
- **Current Photos of the Property**
- **Marketing Materials**
  - All Marketing Material
  - PowerPoint Presentations
  - Marketing Material needs to be approved by a FINRA Principal as set forth in Rule 2210

C. Sponsors

Careful due diligence requires a review of the sponsor's background, property management experience within the sector to which the real estate is associated, financial status and liquidity. FINRA Regulatory Notice 10-22 reminds broker-dealers of their obligation to conduct reasonable due diligence of issuer's underlying management, assets, and

prospects for future business success. Monetary and regulatory repercussions have followed sponsors and selling group members in prior cases where (i) insufficient sponsor-level due diligence was undertaken by FINRA member firms prior to their participations in the program and (ii) where material weaknesses discoverable through reasonable sponsor due diligence were not disclosed in the PPM.

D. Third-Party Due Diligence Reports

It is common practice for sponsors to obtain a third-party due diligence legal opinion or report from industry experts and/or law firms. These reports are intended to provide selling group firms (and in some cases their advisors and consultants) with an objective summary and opinion of the offering's features, benefits, and risks. In turn, these reports/opinions are used by broker-dealers in determining a DST product's suitability.

In most cases, the third-party due diligence legal opinion or report will address the DST product in terms of its (i) legal/tax structure, (ii) management, (iii) costs, (iv) conflicts and (v) risks. In some cases, the third-party opinions or reports may provide independent assessments as to the future economic viability of the DST property and its ability to provide periodic distributions and return invested principal within an assumed holding period (i.e., 5-10 years). In preparing this assessment, the sponsor's proforma is used as a foundational resource, but with the due diligence provider utilizing its own economic assumptions pertaining to rents, market growth and occupancy, operating expenses and improvements, debt service and exit cap rates. This type of analysis can be very helpful to financial advisors in respect to their abilities to assess a DST issuer's assets and prospects for future success.

In the event a DST includes elements that are outside typical industry standards and practice, the due diligence firm should describe the special provision in its report and the potential ramifications of such elements and whether it has an impact on the due diligence firm's recommendation.

A third-party report should be completed prior to or shortly after the effective date of an offering so due diligence personnel at the selling group level (e.g., DDOs, Investment Committees, and their support staff) have reasonable time to review the third-party report and to factor the report into their product approval process. The thirdparty report should be received and reviewed prior to any recommendations to investors.

PART VI. DST SECURITIES PRACTICES

A. Suitability

When a PPM states in the "Who May Invest" section that only accredited investors may participate, broker-dealers should ensure that offers are only made to persons who are accredited investors (within the meaning of Rule 501(a) of Regulation D). Typically a DST investor owns real estate which the investor has sold, or plans to sell, pursuant to a deferred Section 1031 exchange. It is the financial advisor's obligation to determine whether the investor is suitable for the investment and that the investor understands the transactions and associated risks.

A broker-dealer is required to complete a three-point suitability analysis.

- The broker-dealer must have a reasonable basis to believe, based on reasonable diligence, that the offering is suitable for at least some investors. The broker-dealer's due diligence must provide the broker-dealer with an understanding of the potential risks and rewards associated with the offering. A failure to perform such due diligence or understand the offering violates the suitability rule.

- A broker-dealer must have a reasonable basis to believe that the offering is suitable for the specific investor based on the investor's investment profile. The broker-dealer must have a clear understanding of the investment goals and current financial status of the investor.
- A broker-dealer must have a reasonable basis to believe that a series of recommended transactions, even if suitable when viewed in isolation, are not excessive and unsuitable for the investor when taken together in light of the customer's investment profile. The broker-dealer must, with respect to each investor, consider the risks from over-concentration against the benefits of tax deferral and the investment potential of the underlying real estate asset.

If a broker-dealer has not separately performed due diligence or has not received a thirdparty due diligence report, then the broker-dealer will not be able to carry out its required suitability analysis.

Financial advisors should not participate in a transaction if the financial advisors are aware that the investor has not properly and timely identified the DST as replacement property within the 45 day period and the investor is participating in a Section 1031 exchange.

Under Regulation BI (17 C.F.R. 240.15l-1), broker-dealers and their associated persons (i.e., registered representatives), in making securities recommendations, must exercise reasonable diligence, care, and skill to: (i) understand the potential risks, rewards, and costs associated with the recommendation, and (ii) to have a reasonable basis to believe that the recommendation is in the best interest of a retail customer based on that retail customer's investment profile and the potential risks, rewards, and costs associated with the recommendation. Thus, in evaluating whether (or not) to offer a DST interest, broker-dealers should consider the amounts of syndication fees (e.g., commission, managing dealer fees, wholesaler fees, and marketing, and due diligence allowances), as well as the overall front-end load (which includes syndication costs, offering/organizational expenses, and sponsor/affiliate mark-ups on acquired DST properties) as well as ongoing fees.

In making a suitability determination in connection with a recommendation to a customer, a broker-dealer must consider whether the fees and expenses associated with DST transactions outweigh the potential income tax benefits to the customer. DSTs structured with high up-front fees and expenses paid to the sponsor and/or salespersons of the selling broker-dealers raise concerns about the ability to make a suitable recommendation. Given the "best interest" standard imposed upon broker-dealers under Regulation BI, a recommended practice would also be to consider how the DST compares to other DST products in terms of offering costs, sector risk, market fundamentals, and prospects for future economic success.

B. Broker-Dealer Supervision of Registered Representatives

A broker-dealer selling DST interests must establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable rules of FINRA.

Broker-dealers must make sure that their representatives are properly trained on complex product features, risks, and suitability.

Persons selling DST interests must have appropriate licenses, for example, Series 7 or Series 22, and a Series 63

in those states in which it is required. The broker-dealer's written supervisory system should ensure that neither the member nor its registered representatives pay referral fees or otherwise share transaction-based compensation from DST transactions with persons that would be deemed to be unregistered broker-dealers. A broker-dealer should not share commissions with real estate brokers, nor reduce its commission in an arrangement to allow the sponsor or investor to pay a real estate agent or other non-securities licensed person for participating in the transaction or for referring business to the broker-dealer.

In addition, the broker-dealer should monitor and educate its representatives to understand if the representatives are engaged in any general solicitation and if so, is the brokerdealer in compliance with the contemplation rule discussed below.

C. Contemplation Rule

If a communication is made by a general solicitation, then an issuer or its agents will have made a prohibited general solicitation if the communication includes an offer of the privately placed securities in a Rule 506(b) offering. If the communication references a security that is currently offered or contemplated to be offered at the time of the communication, the communication will generally be considered an offer of that security in a Rule 506(b) offering. In addition, if the person solicited via the communication is subsequently offered a security that was currently offered or contemplated to be offered at the time of the communication, the communication would generally be considered an offer of that security. (In the matter of D.H. Hill Securities, LLLP; KCD Financial Inc. (March 29, 2017); and William H. Murphy & Co., Inc., Houston, Texas and William H. Murphy, Houston, Texas.)

- This means that a financial advisor cannot sell a DST to an Investor in a Rule 506(b) offering if the investor is obtained through any type of general solicitation (even if the specific DST was not referenced) when the DST offering was contemplated or available for sale at the time the investor was first engaged.

D. Pre-existing Relationships

Offers and sales of securities may only be made to those persons identified through a general solicitation of a financial advisor: (i) after a substantive preexisting relationship has been established, and (ii) in a Rule 506(b) offering, which offering became available after the establishment of the relationship, and the offering must not have been contemplated at the time of the establishment of the relationship. A preexisting relationship is not based on time but is based on the quality of the relationship. The quality of the relationship between an issuer (or its agent) and an investor is the most important factor in determining whether a "substantive" relationship exists. A "substantive" relationship is one in which the issuer (or a person acting on its behalf) has sufficient information to evaluate, and does, in fact, evaluate, a prospective offeree's financial circumstances and sophistication, in determining his or her status as an accredited or sophisticated investor. See Citizen VC, Inc. (August 3, 2015).

E. General Solicitation

There are several different ways general solicitation can impact an offering. First, there can be general solicitation by a financial advisor. In the event the general solicitation is solely by the brokerdealer and about the financial advisor, the financial advisor needs to ensure that any sale to an investor is consistent with the contemplation rule discussed above. Second, there is general solicitation by an issuer. If the issuer is participating in a Rule 506(c) offering then the

issuer must be in compliance with Rule 10-b5. If the issuer is participating in a Rule 506(b) offering the issuer must be aware of the general solicitation prohibitions. Many issuers appear to look to the practices of other issuers to determine compliance. The problem, however, is that the other issuers may be involved in public offerings, Regulation A offerings or Rule 506(c) offerings and will not have the same limitations and prohibitions as issuers who are utilizing Rule 506(b). Issuers should closely monitor the information being published on their website and any other website accessible by the general public. There should be no information on the website of the issuer regarding securities offerings including but not limited to prior performance. One of the areas that many issuers seem to violate is the publication of general information regarding the issuer or their prior closed offerings. The SEC indicated in Alma Securities Corporation (July 2, 1982) that a general tombstone might be acceptable on the completion of an isolated Regulation D offering. However, "where a sponsor or issuer conducts an ongoing program of private or limited offerings, tombstone announcement for the completion of each individual offering could be used to solicit investors to the program as a whole." There are many websites, especially financial advisor websites, that are including this information which may cause a loss of the Regulation exemption. In addition, the SEC generally has looked at the purpose for providing information about the issuer and has indicated that general marketing in order to increase the name and stature of the issuer in order to sell additional securities is a violation of the general solicitation rule. See Remco Securities Co., Inc. (July 22, 1984) and Gerald F. Gerstinfeld (June 18, 1984).

F. Sales Materials & Marketing Rules

FINRA Rule 2210(d)(1) requires that all member firm retail communications be fair, balanced and not misleading. **Communications that promote the potential rewards of an investment also must disclose the associated risks in a balanced manner.** In addition, communications must be accurate and provide a sound basis to evaluate the facts with respect to the products or services discussed. Certain deficiencies that have been routinely raised by FINRA within its enforcement releases and advertising review letters include: (i) the absence of risk disclosures placed within the confines of the subject marketing material (with simple references to a PPM's risk factors section being insufficient for FINRA Conduct Rule 2210 compliance purposes); (ii) failures of the marketing materials to disclose the illiquid nature of the investment; (iii) misleading comparisons of DSTs to other securities that provide periodic income; and (iv) presentations of yield rates or return targets within the marketing materials.

Rule 2210(d)(1)(F) prohibits the use of any prediction or projection of performance. Accordingly, retail communications concerning private placements may not project or predict returns to investors such as yields, income, or capital appreciation percentages or marketing materials. However, FINRA does not consider reasonable forecasts of an issuer's operating metrics (e.g., forecasted revenues) that may convey important information regarding the issuer's plans and financial position to be inconsistent with the rule. Presentations of reasonable forecasts of issuer operating metrics should provide a sound basis for evaluating the facts as required by FINRA Conduct Rule 2210(d)(1)(A). For example, such presentations should include clear explanations of the key assumptions underlying the forecasted issuer operating metrics and the key risks that may impede the issuer's achievement of the forecasted metrics.

While sources of revenue, such as master lease agreements, may inform or provide a basis for reasonable forecasts of issuer operating metrics, it would be inconsistent with FINRA Conduct Rule 2210(d)(1)(B) to characterize specific revenue or cash flow as guaranteed or certain. Also, while a property-level pro forma depicting rents, expenses, and net

income are allowed to be presented within offering materials (but not marketing materials) if predicated upon reasonable operating assumptions and tempered with prominent risk disclosures, a statement of a forecasted or targeted yield to the investors is not permitted under Rule 2210. In Regulatory Notice 20-21 FINRA indicated that in the event that an issuer separately wrapped or highlighted information in an offering memorandum to effectively create a separate marketing piece wrapped around the PPM, that FINRA would treat that “wrapper” as marketing material.

The sources of the information used in the sales material should be referenced.

G. Timing of Information Flow for New Offerings

To allow sufficient time for sponsors, distribution partner firms and registered representatives to properly evaluate the offering while working within the framework of the prohibition of general solicitations, we recommend that information be shared with the various parties involved in the offering during the following time periods.

Sponsor Evaluation Period

While a sponsor is initially evaluating a property and beginning the initial stages of preparing the offering documents, no information should be shared outside of the sponsor company and its advisors (including outside due diligence reviews). Each sponsor should evaluate its policies carefully to determine if sponsor marketing personnel should know about the possible offering at this early stage. To prevent the premature disclosure of information to financial advisors, no pre-marketing or announcements are to be made during this period. However, this should not precent interaction with a broker-dealer regarding structure preferences as long as (i) information regarding the property is kept confidential and (ii) it is not an attempt or a disguised attempt to pre-sell the offering.

Contemplation Period

A Contemplation Period would commence upon the announcement of the offering to the marketplace. The announcement should be made to all firms on the same day to establish a consistent date when contemplation of the offering begins. This is necessary to determine when, and to which investors, offers may be made under general solicitation rules. During the Contemplation Period, due diligence professionals could receive an initial due diligence package or verbal information on an upcoming offering. This will allow them to organize their due diligence queue and in certain situations begin preliminary due diligence prior to receiving the full final due diligence kit and PPM.

Financial Advisor Due Diligence Cooling Off Period

A Due Diligence Period begins after the close of the property and when the final PPM and complete due diligence package is sent to the financial advisors. The duration of this period should be long enough to allow the financial advisors to conduct adequate due diligence. The obligation of the financial advisor is based on the substance of the review and not the duration of the review period. A thorough review in 2 days is better than no substantive review in 10 days. It is recommended that this cooling-off period last a minimum of 3 business days. If a sponsor employs an allocation method, sufficient time is still required for the financial advisor to complete their diligence and approve the offering. A Third-Party Due Diligence Report should be received prior to the conclusion of the Due Diligence Period to provide all firms with this information prior to product approval. Selling agreements should not be executed until the Cooling Off Period ends. The same limitations on providing information to registered representatives applicable in the Contemplation Period should also apply in the Due Diligence Period, meaning client PPMs should not be distributed to representatives

unless and until a signed selling agreement or other authorization has been received from authorized personnel at the distribution firm. No investor paperwork should be accepted during this time.

Marketing Cooling Off Period

Following the Due Diligence Period and if a selling agreement is executed, registered representatives may distribute client materials to potential investors that meet the satisfactory requirements of the offering. Adequate time should be provided to registered representatives and potential investors to review offering materials and make an investment decision before orders are accepted. Once again, the emphasis is on a substantive and thorough review and not time. The recommendation is a minimum of 2 business days. As with the Due Diligence Cooling Off Period, no investor paperwork should be accepted and considered received and in good order during this time.

Order Acceptance Period

A sponsor may accept investor paperwork for an offering only during the Order Acceptance Period, which begins at the conclusion of the Marketing Cooling Off Period.

H. Subscription Paperwork and Recordkeeping

Broker-dealers are required by FINRA to have written procedures regarding the approval of all securities transactions. These reviews and approvals must be made by a properly licensed registered principal and should be documented in writing.

Principal review and approval must be obtained by the broker-dealer. To facilitate such review, Purchaser Questionnaires and other instructions accompanying subscription documents should direct subscribers to send all completed subscription documents to their registered representatives and/or broker-dealer. In addition, the Purchaser Questionnaire or related documents should include a signature block for the broker-dealer. If a sponsor receives a Purchaser Questionnaire and related documents lacking a broker-dealer principal signature, the paperwork should be rejected and returned to the broker-dealer.

Broker-dealers are required by FINRA to retain certain books and records related to all securities transactions, including DSTs. These requirements include data related to investors, products, and transactions, among other areas. Broker-dealers should ensure that their books and records retention systems comply with FINRA rules in terms of the scope of data to be retained and the manner and time periods of retention.

Sponsors should clearly define their reservation requirements to their internal sales team, due diligence community, and representatives prior to the commencement of the Order Acceptance Period. It is imperative that all parties be aware of the requirements for their reservations to be accepted in good order. Sponsors should also consistently communicate their available equity before agreements are received, during due diligence, and after agreements are received. Transparency in the sponsor's DST launch, due diligence, and paperwork acceptance processes will aid in all parties working better together.

I. Post-Closing Items

Filings & Agreements

Executed selling agreements and reallowance agreements should be returned from the sponsor after placing their signature to the broker-dealer for their records. A broker-dealer must effectuate a FINRA Rule 5123 filing within 15

calendar days after the first sale. Additionally, a financial advisor should follow up with the sponsor to ensure that a Form D was filed with the SEC within 15 calendar days after the first sale, and that appropriate Blue Sky filings were timely filed within the states in which the DST's interests were sold (with New York imposing a pre-filing requirement to perfect a notice filing at the state level).

Closing Documents

Unless otherwise agreed by the financial advisor and sponsor, three full sets of closing documents should be sent as soon as practicable after closing. They should be sent to the financial advisor through electronic or hard copy. Investors should receive a hard copy and may opt-in to electronic communications.

Investor Communications

The sponsor should communicate all relevant information concerning the property to the investor on a regular and continuous basis. The sponsor should provide to each investor and their broker-dealer and registered representative: (i) quarterly and annual property performance reports, (ii) relevant tax information, and (iii) any other material information concerning the property including the use of the reserves.

Financial Reports & Audits

ADISA supports transparency regarding the performance of DST products. Performance reports for each property should compare current performance to (i) the PPM pro-forma and (ii) annual budgets. This reporting should include effective gross income, expenses, net operating income, current cash flow, and the balance in each reserve account. On this point, some sponsors provide cash flow audits of a DST property's revenues and capital costs/expenses, which is preferred. The DST's reporting obligations to the investors should be stated in the PPM, trust agreement, and asset management agreement. The minimum standard for such reporting would be annual, although more frequent reporting (quarterly) may be desirable in appropriate circumstances.

The Alternative & Direct Investment Securities Association (ADISA) drives growth, innovation and excellence in the alternative investment industry through best-in-class networking, education and advocacy.

450 East 96th Street
Suite 185
Indianapolis, IN 46240
317.663.4180 main
866.353.0871 toll free

adisa.org