Inland Private Capital Corporation

1031 Exchange Solutions & Investing in Private Placements

A Presentation for Certified Public Accountants

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- Investors should not assume they will be able to resell their interests.
- There is no guarantee that the investment objectives of any particular IPCC-sponsored program will be achieved.
- The actual amount and timing of distributions paid by IPCC-sponsored programs is not guaranteed and may vary. There is no guarantee that investors will receive distributions or a return of their capital.
- Investments in real estate are subject to varying degrees of risk, including, among other things, local conditions such as an oversupply of space or reduced demand for properties, an inability to collect rent, vacancies, inflation and other increases in operating costs, adverse changes in laws and regulations applicable to owners of real estate and changing market demographics.
- Investors should be able to bear the loss of their investment.
- IPCC-sponsored programs depend on tenants for their revenue, and may suffer adverse consequences as a result of any financial difficulties, bankruptcy or insolvency of their tenants.
- IPCC-sponsored programs may own single-tenant properties, which may be difficult to re-lease upon tenant defaults or early lease terminations.
- Continued disruptions in the financial markets and challenging economic conditions could adversely affect the ability of an IPCC-sponsored program to secure debt financing on attractive terms and its ability to service that indebtedness.
- The prior performance of other programs sponsored by IPCC should not be used to predict the results of future programs.
- The IPCC-sponsored programs do not have arm’s length agreements with their management entities.
- The IPCC-sponsored programs pay significant commissions and fees to affiliates of IPCC, which may affect the amount of income investors earn on their investment.
- Persons performing services for the managers of the IPCC-sponsored programs perform services for other IPCC-sponsored programs, and will face competing demands for their time and service.
- The acquisition of interests in an IPCC-sponsored program may not qualify under Section 1031 of the Internal Revenue Code of 1986, as amended (the “Code”) for tax-deferred exchange treatment.
- Changes in tax laws may occur, and may adversely affect an investor’s ability to defer capital gains tax and may result in immediate penalties.
- The DST structure is inflexible and, in certain events, may be converted to a LLC structure, which would have a tax impact on investors.

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What is a 1031 Exchange?

- Section 1031 of the Code provides an alternative strategy for deferring the capital gains tax that may arise from an investor’s business/investment property sale.
- By exchanging the property for **<u>like-kind</u>** real estate as defined on the following slide, property owners may defer their Federal taxes and use all of the proceeds for the purchase of replacement property.
- Whether any particular transaction will qualify under Section 1031 depends on the specific facts involved, including, without limitation, the nature and use of the relinquished property and the method of its disposition, the use of a qualified intermediary and a qualified exchange escrow, as discussed in more detail on the following slides, and the lapse of time between the sale of the relinquished property and the identification and acquisition of the replacement property.

Diebold Data Center – Miami, FL

Section 1031 Under Attack!

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During Tax Reform discussion members of the Democrat Leadership in the Senate and members of the Republican Leadership in the House and the President's budget all discussed the elimination of the 1031 Exchange and/or capping them at $1 million.

The good news is nothing will happen this year regarding the 1031 Exchange…the bad news is the discussion of elimination has happened in a bi-partisan fashion.

We are diligently working with the national coalition of real estate industry leaders on a plan to identify how the 1031 benefits the U.S. Economy…in addition we are working to educate our elected leaders and their staff of the importance of the 1031 Exchange. Representatives from Inland will be heading to Washington D.C. this week to meet with our industry coalition partners to identify the very best way to educate members of Congress as to the importance of the 1031 Exchange!

What is "Like Kind"?

- Vacant land
- Commercial rental property
- Commercial property
- Industrial property
- 30-year or more leasehold interest
- Farm property
- Residential rental property
- Doctor's own office
- Tenant in common interest* in investment property
- **Beneficial Interest in a DST**
- Both the relinquished and the replacement properties must have been **held for investment purposes** or for productive use in a trade or business.

*Tenant in Common (TIC) ownership – Ownership of commercial real estate that has been split into fractional shares. Each owner owns an undivided fee interest in the property equal to his proportionate share of the real estate.

Key 1031 Guidelines to Remember

- Seller cannot receive or control the net sale proceeds – the proceeds must be deposited with a **Qualified Intermediary.**
- Replacement property must be **like-kind** to the relinquished property.
- The replacement property must be identified within **45 days** from the sale of the original property.
- The replacement property must be acquired within **180 days** from the sale of the original property.
- The **cash invested** in the replacement property **must be equal to or greater** than the cash received from the sale of the relinquished property.
- The **debt placed** or assumed on the replacement property **must be equal to or greater** than the debt received from the relinquished property.

This is a summary of some of the key guidelines for a transaction under Section 1031, but this is not an exhaustive list. The costs associated with a 1031 exchange may impact an investor's returns and may outweigh the tax benefits of the transaction. Each prospective investor must consult his or her own tax advisor regarding the qualification of a particular transaction under Section 1031.

Question: Does a beneficial interest in a DST quality as “like-kind” replacement property in an exchange?

What is a Qualified Intermediary?

- The Qualified Intermediary ("QI") is a company that is in the full-time business of facilitating Section 1031 tax-deferred exchanges. The role of a QI is defined in Treasury Regulations. The QI enters into a written agreement with the taxpayer where QI transfers the relinquished property to the buyer, and transfers the replacement property to the taxpayer pursuant to an exchange agreement. The QI holds the proceeds from the sale of the relinquished property in a trust or escrow account in order to ensure the taxpayer never has actual or constructive receipt of the sale proceeds.

- The identification and replacement timelines should be monitored by the QI and the identification is done through the QI.

Qualified Intermediary - Disqualified Parties

- Neither the taxpayer nor a “disqualified person” may serve as a QI.

- A “disqualified person” is someone who is the agent of the exchanger at the time of the exchange. A person who has acted as the taxpayer’s employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the two-year period preceding the date of the transfer of the first relinquished property is treated as an agent of the exchanger, and thereby a disqualified person. If an attorney has provided tax or legal services to the exchanger within the prescribed two-year period, the attorney is a disqualified person. The exchanger should, however, consider retaining an attorney to provide assistance with complicated closing documents and other aspects of the exchange.

1031 Exchange Bits & Pieces

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- Vacation and second homes may qualify for exchange, if certain conditions are met.
- Investors may take some cash proceeds from the sale before the funds are sent to the qualified intermediary. The investor will pay capital gains tax on the cash but not the proceeds that were reinvested.
- Upon the death of the owner of the property, under current tax laws, the heirs would get a “step up” in basis, thereby avoiding all capital gains taxes on the original and subsequent properties. This may be an estate planning strategy for an investor.

- An offering of DST interests may also be appropriate for replacement properties in a 1033 exchange, which uses proceeds derived from an eminent domain condemnation
or an insurance settlement as a result of a catastrophe.

The Delaware Statutory Trust

Delaware Statutory Trust (DST):
In accordance with the Internal Revenue Service's Revenue Ruling 2004-86, a beneficial interest in the Delaware Statutory Trust, which holds the replacement property, can be considered "like-kind" replacement property in an exchange. A DST may own one or more properties.

The rights and obligations of investors in a DST will be governed by the DST's trust agreement. Typically, investors have limited voting rights over the operation and ownership of any properties owned by the DST. In addition, the trustees of the DST will be entitled to certain fees and reimbursements, as set forth in the applicable trust agreement.

<u>Multiple Ownership Structure</u>

Multiple Investors in each property with the percentage of beneficial ownership varying from one investor to the next.

Mariano's Grocery Store – Arlington Heights, IL

Understanding the Delaware Statutory Trust

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Often used in multiple-owner, securitized programs, benefits of the DST structure exist for both the exchanger and, if a property is financed, the lender. Among these benefits are the following:

- The lender makes only one loan to one borrower (the DST).
- The trust agreement is written to prevent creditors of the exchanger from reaching the DST's property, therefore making it bankruptcy remote.
- The DST shields the exchanger from any liabilities with respect to the property.
- Exchangers have no operational control over the management of the DST or its property.
- Because exchangers have no operational control over the DST, the lender has no need to perform due diligence on individual exchangers.
- Because exchangers have no operational control over the DST, exchangers should also not be required to sign any indemnifications or guarantees.

Understanding the DST

Although the DST has many attractive features, care must be taken to follow the prohibitions on the power of the trustee, as described in IRS Revenue Ruling 2004-86.

- No capital contributions may be made by new or existing beneficiaries after the offering is fully subscribed.
- The DST cannot renegotiate its existing mortgage debt or enter into new or replacement mortgage debt unless a property tenant is bankrupt or insolvent.
- The DST cannot renegotiate its existing lease(s) or enter into new leases or lease extensions unless a property tenant is bankrupt or insolvent.
- The trustee cannot reinvest proceeds of the sale of its real estate.
- Capital expenditures may only be made for normal repair and maintenance or improvements required by law.
- Any cash held between distributions may only be invested in short term debt obligations.
- All cash, other than reserves, must be distributed on a current basis.

Hypothetical Illustration of a commercial property sale with no 1031 exchange

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Sales Proceeds:	$1,000,000
Less Mortgage Balance:	0
Net Sales Proceeds:	**$1,000,000**
Original Cost:	$100,000
Capital Gain:	$900,000
Fed Tax on Gain @ 20%	($180,000)
State Tax on Gain @ 5.1%*	($45,900)
Funds available for reinvestment:	**$774,100**

() represents amounts being subtracted

***2013 U.S. state average capital gains tax per www.taxfoundation.org**

Question: Does a beneficial interest in a DST give personal liability to the investor on the loan (assuming there is financing)?

Hypothetical Illustration of same commercial property sale with a 1031 exchange

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Sales Proceeds:	$1,000,000
Less Mortgage Balance:	0
Net Sales Proceeds:	**$1,000,000**
Original Cost:	$100,000
Capital Gain:	$900,000
Fed Tax on Gain @ 20%	($0)
State Tax on Gain @ 5.1%	($0)
Funds available for reinvestment:	**$1,000,000**

Hypothetical Comparison of $ Available to Reinvest

	No Exchange	1031 Exchange
$ to Reinvest	$774,100	$1,000,000

There can be no guarantee that investors will receive income or a return of their capital.

Capital One Bank Branch – Houston, TX

Hypothetical Illustration of a 1031 Exchange of a Property with Debt

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A hypothetical investor has found a buyer for his property and upon closing the sale, the sales proceeds are sent to his QI. The clock begins ticking on his identification and replacement timelines. The investor does not take possession of any funds at closing.

Relinquished Property:

Sales Price:	$1,100,000
Debt Paid Off:	500,000 (45%)
Equity	$ 600,000

Hypothetical Illustration Continued: Replacement Property

The hypothetical investor decides to invest in a multiple-owner DST private placement offering so that he can forgo the management responsibilities of having his own property. He makes his identification through his QI before expiration of his 45 days.

This DST owns a portfolio of investment grade retail stores, and the terms of the private placement offering look like this:

Equity:	$13,825,153
Debt:	$13,035,000
Total Offering Price:	$26,860,153
Loan to Offering Price Ratio:	48.53%

Hypothetical Illustration Continued: The Exchange

The hypothetical investor instructs his QI to send his funds to the DST to purchase his replacement property before expiration of his 180 day timeframe. Ownership of his replacement property looks like this:

$600,000 investment into total equity of $13,825,153 = 4.34% ownership interest

Equity:	$ 600,000 or 4.34% of total equity
Debt Assumed*:	565,719 or 4.34% of total debt
Total Investment	$1,165,719

* For purposes of determining liabilities assumed with respect to the properties in connection with this investor's Section 1031 exchange, the investor is allocated a pro rata percentage of the debt.

Hypothetical Illustration Continued: Relinquished vs. Replacement

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Relinquished:

Equity:	$ 600,000
Debt:	500,000 (45%)
Total Investment:	$1,100,000

Replacement:

Equity:	$ 600,000
Debt:	565,719 (48.53%)
Total Investment:	$1,165,719

The investor has satisfied the safe harbor rules of completing an exchange within his timeframes while meeting or exceeding the relinquished property's equity, and debt.

Cash Investments: Potential Advantages of Owning Commercial Real Estate through Fractional Ownership

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- Portfolio diversification
- Value tied to bricks and mortar
- May provide hedge against inflation
- Income generated, if any, may be considered passive income (see next slide)
- Capital appreciation possible on sale
- Potential tax advantages through depreciation and other tax deductions may provide attractive taxable equivalent yields
- In the event of a profitable sale, owners may explore the possibility of deferring the tax on their capital gain through an IRS section 1031 exchange

Because each investor’s tax implications are different, investors should consult with their tax advisors.

Question: Are DSTs portfolio income or passive income?

Passive Income & Passive Losses

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Passive Income: The income from a business in which the individual does not regularly and materially participate.

Passive Loss: Any loss from a business in which the individual does not regularly and materially participate. Passive losses can be used to offset only passive income and not wage or portfolio income*.

*Portfolio Income: The income from interest, dividends and other nonbusiness investments.

Source: PassTrak Series 7 Principles and Practices

Make PALs with your PIGs

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- IPCC's private placement offerings **may be passive income generators** ("PIGs").
- Investments in other passive real estate programs with expenses that exceed cash flow will result in Passive Activity Losses ("PALs"). The only way to get **a tax benefit from these passive losses**, prior to the disposition of the real estate, is to have passive income. Passive losses are not deductible against any kind of income except passive income.

- **There is no guarantee that any private placement offering will generate passive income.** The rules regarding the deductibility of passive losses (whether from an investment in an interest, or from another passive activity that potentially could be used to offset income from an investment in an interest) are complex and vary with the facts and circumstances particular to each investor. In addition, any income may be subject to the 3.8% Medicare Contributions Tax imposed on rent and other types of investment income for tax years beginning after 2012. Potential investors must consult with their own tax advisors regarding their ability to offset any passive income they have with passive losses.

Here’s an example of how the PIG/PAL strategy may work:

A hypothetical investor has $100,000 in passive activity losses. He is looking to carry forward his losses over a 10 year period of time. He is considering an investment which produces 6% in cash flow and has a probable life of 10 years.

Here is a formula the investor might use to determine the amount of money he would need to invest in order to produce $10,000 of passive income to offset his passive losses.

- $100,000 passive activity losses divided by 10 years (carry-forward period)
- Looking to offset $10,000 in passive activity losses per year
- $10,000 passive income / 6% (hypothetical cash flow) = $166,666.00
- Investment of $166,666.00 equals $10,000 of tax free income per year assuming a continuing 6% cash flow

Question: Do DSTs report on a K-1?

Example of a Substitute 1099 & 1098

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Property Location: **Shopping Center**
123 South Boulevard
City, State 12345

Date of Acquisition: 8/20/08
End of taxable year or termination date: 12/31/11
End of Year ownership: 2.6051%

Rental Income:	PROPERTY TOTAL 01/01/11-12/31/11	YOUR 2011 ALLOCATION 01/01/11-12/31/11
Base rental income	$ 1,902,710	$ 49,568
Common area maintenance and real estate tax recovery	705,103	18,369
Other property income	27,558	718
Total gross rent See note regarding 1099 Miscellaneous rent reporting	2,635,371	68,655
Interest expense See note regarding 1098 Mortgage interest reporting	(758,053)	(19,748)
Common area maintenance expenses	(353,863)	(9,219)
Real estate taxes	(314,096)	(8,183)
Property management fee	(131,769)	(3,433)
Insurance	(22,116)	(576)

	PROPERTY TOTAL 01/01/11-12/31/11	YOUR 2011 ALLOCATION 01/01/11-12/31/11
Asset management fee	(10,000)	(261)
Other expense	(28,313)	(738)
Net rental income	1,017,162	26,498
Total interest income (Reserve and Operations accounts) See note regarding 1099 interest income reporting	781	20
Total Net Income	1,017,943	26,519
Mortgage debt: Charter One		
Qualified non recourse debt		
Mortgage balance	$ 13,275,000	$ 345,832
Transfer of account balance	0	0
Ending Balance 12/31/11	13,275,000	345,832

Prior performance is not a guarantee of future results. The actual information contained in substitute 1099s and 1098s may differ materially from this example. There is no guarantee that investors will receive distributions or a return of their capital.

Note: Figures in ()'s are negative numbers.

Example of a Substitute 1099 & 1098

For the period 01/01/11 through 12/31/11
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Co-Owner #4

Property Reserve Accounts:	PROPERTY TOTAL	YOUR 2011 ALLOCATION
Bank		
Beginning balance	$ 890,188	$ 23,230
Deposits from operations	112,756	2,937
Interest earned	781	20
Leasing commission and tenant improvements (see below)	(107,053)	(2,789)
Transfer of account balance	0	0
Ending Balance 12/31/11	896,671	23,399

Tenant improvements and leasing commissions paid from reserve:

Qualified Leasehold Improvements:		
Pet Store (11/02/2010-5/31/2016)	$ 55,000	$ 1,433
Chiropractor (10/01/2009-9/30/2017)	900	23
Appliance Store (2/17/2009-4/30/2014)	10,000	261

	PROPERTY TOTAL	YOUR 2011 ALLOCATION
Total tenant improvements paid from reserve	65,900	1,717

Charges represent tenant improvements. Consult with your tax advisor concerning 2011 depreciation expense as rules for qualified leasehold improvement have become very favorable. These improvements do not change the original asset allocations noted below.

Additions to Leasing commission:		
Card Shop (3/01/2011-2/28/2013)	$ 6,892	$ 180
Electronics Store (1/31/2012-1/31/2014)	4,126	107
Audiologist (5/19/2011-11/30/2016)	7,430	194
Cleaners (12/01/2011-11/30/2016)	3,144	82
Gym (11/15/2011-6/30/2017)	19,562	510
Total Leasing commissions paid from reserve	41,153	1,072

Charges represents the commission paid on each lease. Each tenant in common owner must decide to amortize these commissions over the lease terms or fully expense in the current year.

Total Tenant improvements and Leasing commissions	$ 107,053	$ 2,789

Note: Figures in ()'s are negative numbers.

Example of a Substitute 1099 & 1098

For the period 01/01/11 through 12/31/11
Page 3
Co-Owner #4

The component parts of the property at the time of acquisition are:

	Percentage of Total
Land	43.500%
Land Improvements	6.000%
Building	50.500%
Total costs	100.000%

Due to the sophistication and unique requirements of your exchange, it is recommended that you consult a knowledgeable tax professional to assist you in the filing of your 2011 federal, state, and local income tax returns. Note: many states require you file separate state franchise tax returns that are unrelated to the state income tax. In most cases, your cash investment in the property will not be your tax basis.

This property is located in **City, State**. You should consult with your advisor about your tax filing requirements for this location.

Please note: This operating statement need not be attached to your tax return. The amounts should be used to complete the appropriate tax form.

If you incurred any change of ownership in the current year (sale, death, transfer of interest, etc.), you need to check with your tax advisor of any tax liability arising from the change in your ownership.

For the tax year 2011, this statement serves as a substitute for:

- **Form 1099 Miscellaneous** for reporting the gross rental income
- **Form 1099 Interest Income**
- **Form 1098 Mortgage Interest Paid**

These amounts will be reported to the Internal Revenue Service.

Note: Figures in ()'s are negative numbers.

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Questions?