ALTERNATIVE INVESTMENTS QUARTERLY

AI QUARTERLY

SPRING 2023
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COMMUNICATION & MARKETING

OIL & GAS

EDUCATION

TRANSPARENCY

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ALIGNMENT OF INTEREST

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Executive Director's Letter

By John Harrison, *DBA*
Executive Director, ADISA

ESG, After a Fashion

If you follow college gridiron football at all, you know about my alma mater's, the University of Georgia, recent championship performances. About 40 years ago when they won their first football championship, they were also the nation's premier institute around the science of ecology. And I had the good fortune of studying under the "father of ecology" (Eugene Odum) while majoring in biology there.

Dr. Odum came late to lecture one day, explaining he had just returned from cutting the ribbon at a new recycling center in another city. He confessed that they just about chased him out of town because of his impromptu remarks at the ribbon cutting:

He told them, "This is a fine recycling center; you're to be commended for your efforts. I hope it will be here still several years from now, but I'm afraid the economics might not allow that. But again, thanks for your hard work." Before I had graduated some two years later in 1980, the recycling center had already closed.

In his textbook, *Fundamentals of Ecology*, arguably the most influential work on the environment after Rachel Carson's *Silent Spring*, Dr. Odum weeded out a lot of idealists following a fashion to study a "feel-good" earth-saving science. The academic lightweight faced Odum's text of differential equations, logarithmic graphs of population growth ratios, comparisons of Cesium-137 levels across species, podzol and chernozem soil workups, chlorophyll concentrations, and O2 assimilations. There were systems on top of cycles, and then analyses of life cycles. It was anything but "feel-good" and everything in scientific and mathematical principles.

And then came the economics. The recycling center failed not because many items from commodities are not recyclable in the lab, but because they don't make sense to recycle commercially (by the way, the recycle triangle label indicates only that something is in theory recyclable in a lab). Sometimes, there is no market for the recycled product, so where does it go and who pays to get it there? (And if it's a government expense, it's probably paid for with borrowed money).

But that doesn't mean we can't better fix or invest in things using concern for our environment—the E of ESG. Dr. Odum spoke of shiny new eco-certified buildings that were, well, shiny. By the counting of one reputable scientific article I read, glass-and-steel architecture—mirrored glass, that is—kills perhaps a billion birds per year. It seems rather needless destruction because for a fashion we forgot how to build actual walls with windows?

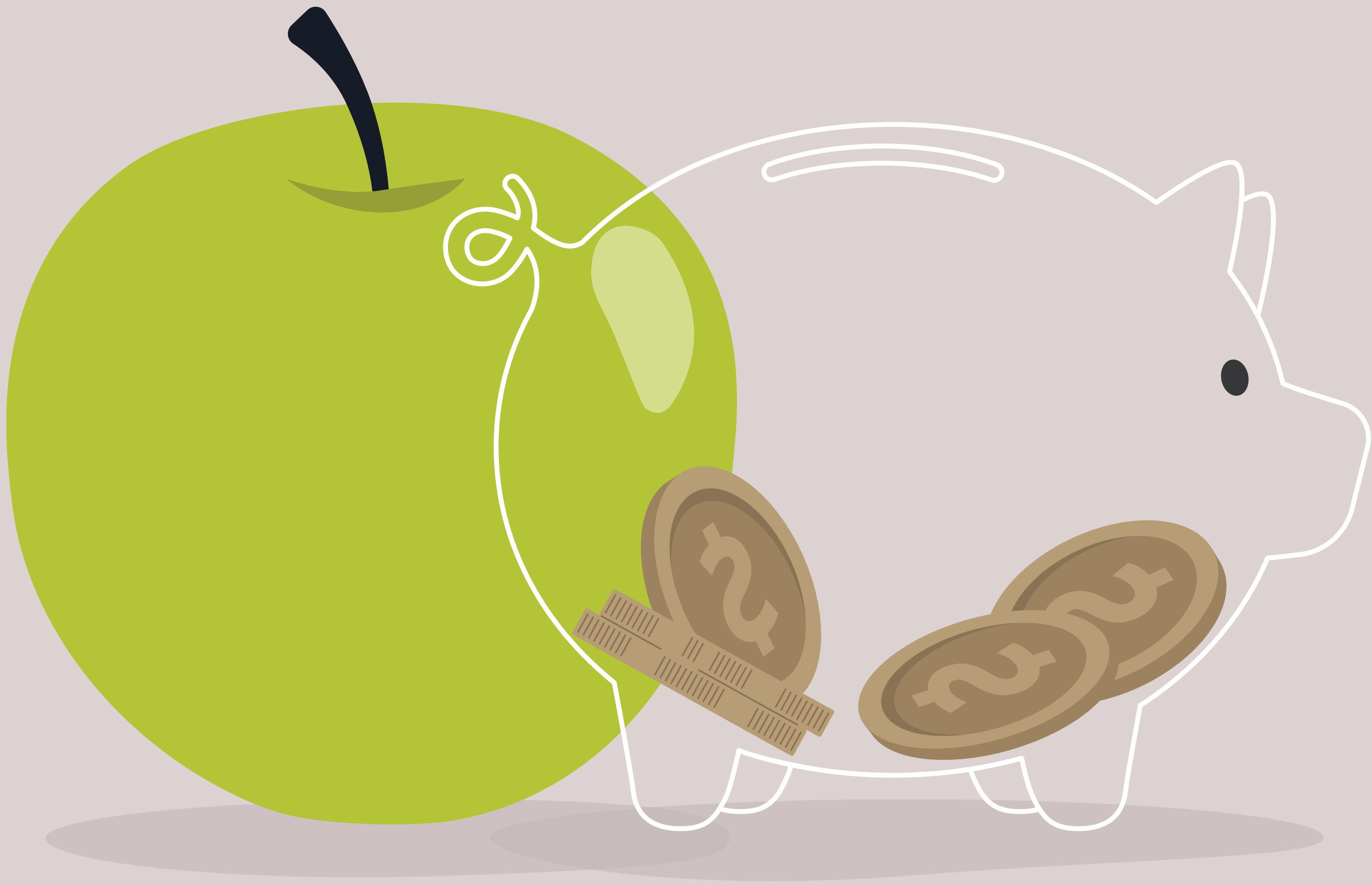
On the other hand, glass itself is inert, meaning that reusing it is fine, but recycling it may not be worth it because it basically never harmfully dissolves. Hence, the Coke bottles that are reused by the local bottler make sense, but spending energy to grind up the glass into something else instead of tossing it in the landfill may not.

It can be a complicated business investing in the E of ESG, both at the fund management level and the advice level. Done well by the experts, you can see it should involve a lot of analytics, and we hope result in a lot of good. Done as a fashion like buildings of mirrored glass, the flightpath for the birds may not be as helpful.

John P. Harrison, ***DBA, CAE***
ADISA Executive Director

Education and Transparency are Essential for the Continued Growth of Alternative Investments

By Michael Underhill, *ADISA President*



Alternative investments continue to grow in popularity among all investors, particularly with retail investors who, along with their financial advisors, have begun to embrace the non-correlated and portfolio diversification benefits that alternatives can provide as a complement to traditional stock and bond investing.

Alternative investments totaled $13 trillion in assets in 2021, according to market research firm Preqin. The total dollar value in these classes has more than doubled between 2015 and 2021 and is forecast to reach $23 trillion by 2026.

Regulation D private placements received nearly $900 billion of investor capital over the past two years, and other illiquid alternatives have similarly attracted billions more.

Of course, as these more sophisticated investing options grow in popularity beyond the traditional institutions that have long embraced alternatives, some in the financial press find them to be easy targets for salacious commentary that obscure the long-term benefits that this expanding investment universe can provide.

The Wall Street Journal's Jason Zweig, as an example, recently penned a column entitled, "An Iowa Farmer Tried to Dodge Stock-Market Turmoil. It Cost Him $900,000." Zweig's column presents a cautionary tale that unfairly criticizes private placements as wholly unsuitable and that they are often sold by "…dodgy brokers and financial advisers."

Like other critics of private placements in the financial media, Zweig uses an inappropriate broad brush in his column that cherry picks a few unfortunate investors to illustrate his point. Untethered by FINRA's "fair and balanced" rules, he fails to also make the salient point that many accredited investors reap benefits from their investments in private placements and

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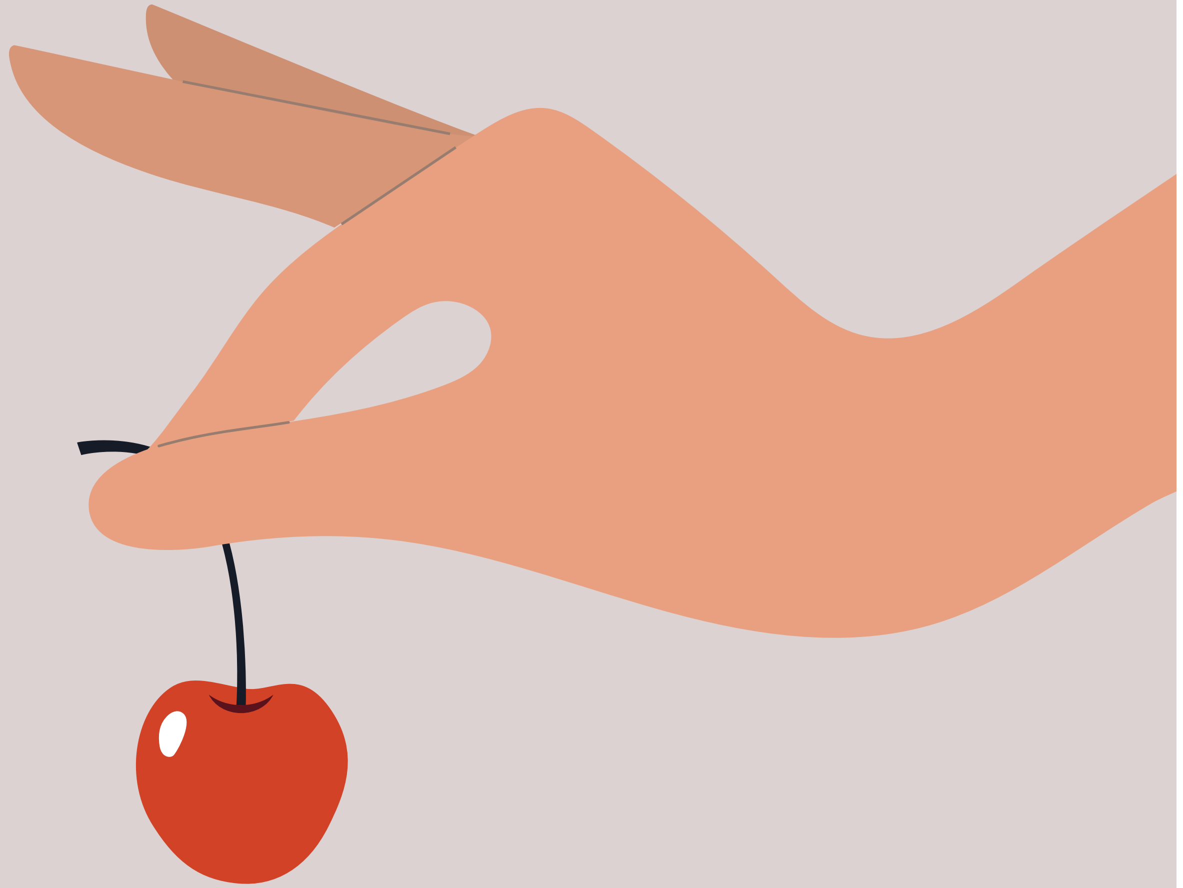

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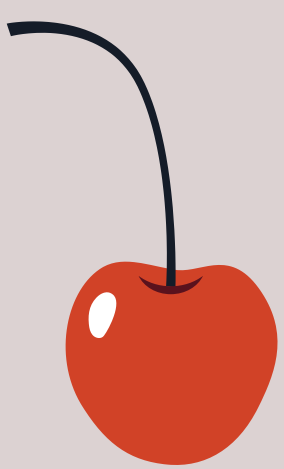

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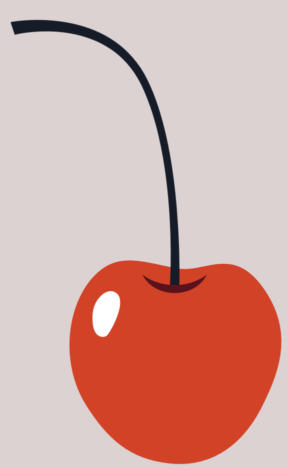
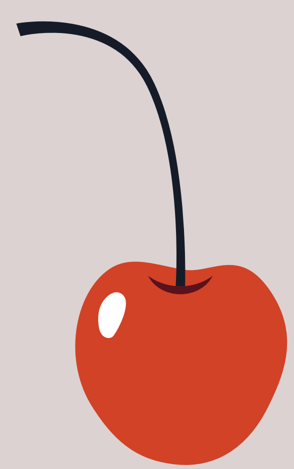




other illiquid alternative investments. It is an ill-informed and potentially dangerous exercise that could lead many to avoid considering the countless opportunities now available to strengthen their portfolios through the adoption of thoughtfully crafted alternative investment opportunities.

As fiduciaries are seeking to help investors reach their retirement goals, their approach can be viewed as a marathon, not a sprint. Time horizons can span decades and incorporate a variety of investments with the goal of generating the appropriate mix of income and growth that meets the clients' goals.

Accredited retail investors gaining access to alternatives creates both challenges and opportunities for all parties involved. Financial advisors and broker-dealers must fully disclose risks introduced with these types of investments to clients and ensure they truly understand the investment opportunity from every aspect. This requires education and training for advisors and their clients regarding asset quality and type as well as potential liquidity limitations with various products.

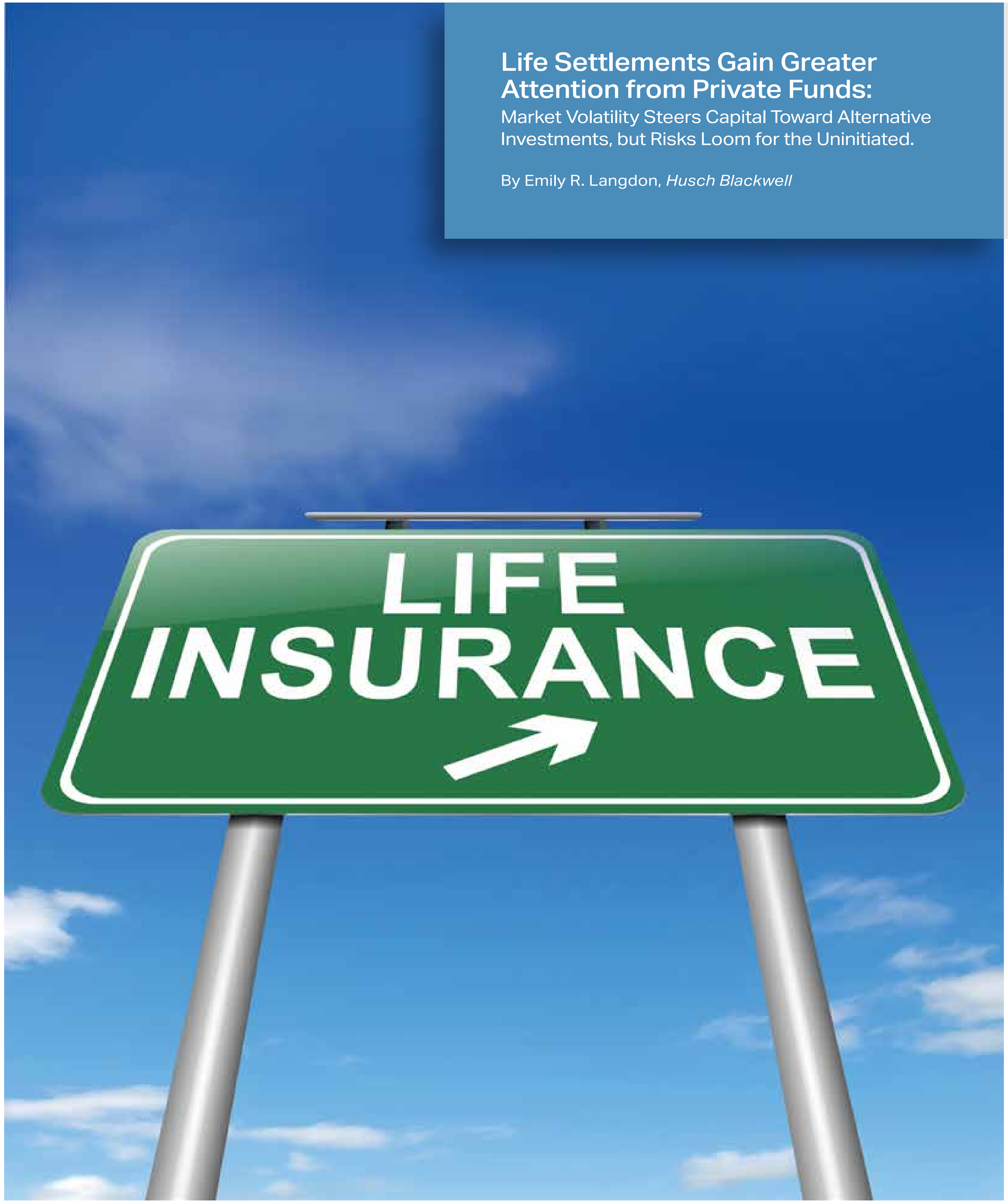
ADISA believes that there is both a financial literacy issue regarding investing in alternative investments and a selling practice issue as it relates to brokers that can be addressed through education, training, and engagement.

Of course, there are bad actors in the securities world, just as there are in every industry. To use a few particularly galling examples, like Zweig employed in his column, to disregard an entire class of investment offerings and those who recommend them is unfortunate, foolish, and dangerous—particularly coming from a columnist published by the nation's most respected financial newspaper.

Investors should always be cautious, both in selecting their investments and those who assist them in managing their wealth. There are countless thoughtful, intelligent, and licensed wealth advisors available to the investing public—a growing number of whom appropriately recommend well-structured and well-managed private placement investments.

As the nation's leading advocacy group for non-traded alternative investments, one of ADISA's foundational goals is to promote financial literacy and best practices that can help to strengthen our community and improve the investment environment. The fact of the matter is that we must all redouble our efforts to ensure that advisors and investors are equipped with well-crafted investment options and that the potential risks, rewards, and processes are properly shared with all parties.

Education, communication and transparency are fundamentally important aspects of the process, and we must all work together to ensure that we continue to improve financial literacy and awareness every step of the way. Your active participation as a member of ADISA is essential to this process, and I encourage you to further engage and improve our shared community for the betterment of all. ▲



Life Settlements Gain Greater Attention from Private Funds:

Market Volatility Steers Capital Toward Alternative Investments, but Risks Loom for the Uninitiated.

By Emily R. Langdon, *Husch Blackwell*

Emily R. Langdon is a partner at Husch Blackwell where she brings her focus on employee benefits and ERISA to bear on myriad issues, including dispute resolution, corporate transactions and M&S, business formation and early-stage funding, and healthcare law and regulation.

Given the threat of a significant repricing across multiple asset classes, investors are looking for fresh ideas. The current bout of market volatility has not spared many categories of investment, as equities and fixed income have moved downward in sympathy, and the outlook for other major classes of investment, like real estate, is clouded by rising interest rates. What investors long for during periods like this are assets that are uncorrelated with financial markets. Many so-called alternative investments are designed to fill that niche; however, these investments don't always escape the gravity of falling financial markets and are more correlated than they might otherwise appear to be, particularly when crisis dynamics take hold.

This predicament partly explains the increasing interest in life settlements from the private fund industry. Life settlement is a means of selling a life insurance policy when the insured no longer needs, wants, or can afford the policy. This class of assets was essentially created by a 1911 U.S. Supreme Court case, *Grigsby v. Russell*, establishing that life settlements are to be treated in much the same way as fundamental property, with the policyowner retaining the right to sell his or her policy. When a policy is taken out, an insurable interest must be present; however, once a policy is issued, the policyowner is granted the same privileges as any other owner of property. As such, the policy can be transferred or sold without restriction, as long as the policy is outside of its two-year contestability period.

Life settlements as an asset class can provide investors with equity-like yields and a superior risk profile, and importantly, they are not correlated with financial markets; however, they are not risk-free. There are important legal and tax implications for life settlement transactions that buyers need to weigh and consider.

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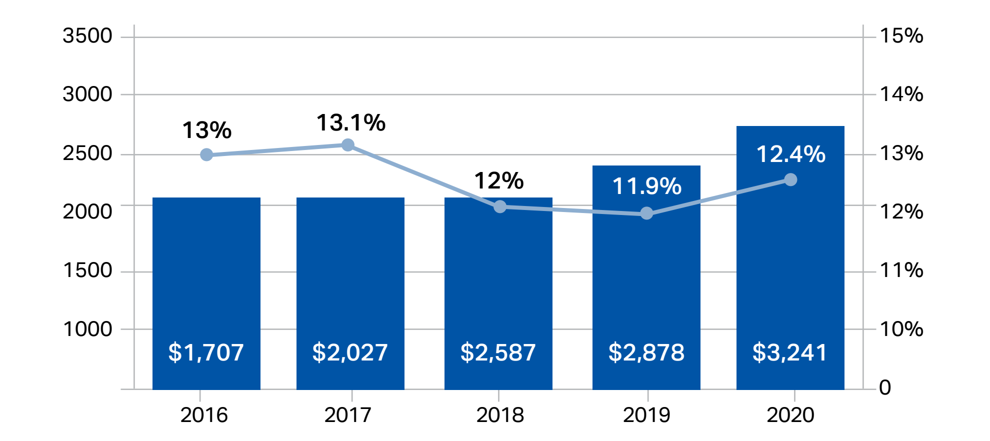
A Case Study

As part of a benefits package, a corporation insured its chief executive officer with a $4.5 million universal life policy, paying $98,000 per year into the policy.

After seven years, the need for coverage had dissipated and the company decided to assess its options. The company was sporadic with the timing and regularity of its payments, but the policy was in good standing despite having zero surrender value. Working with an experienced life insurance representative, who is also licensed for life settlement transactions, legal counsel proceeded to assess the fair-market value of the policy.

The application process is straightforward. Interestingly, an exam or physical is not required. Keep in mind that this is an inverse process from when the policy was issued. The insured filled out an application, signed a HIPAA authorization, and medical records were requested from his physicians. Upon receipt of a complete set of medical records, such records are sent to a life expectancy provider (depending on the dynamics of a case, anywhere from two to five life expectancy analyses are solicited for any given case). The assessments can range from $350 to $500, a cost typically covered by the settlement company.

Life Settlements: Total Policies Sold vs. Median Investor Return



Source: Harbor Life Settlements, "American Seniors Are Losing Billions Every Year, Here's How the Financial Industry Can Help," https://www.harborlifesettlements.com/wp-content/uploads/2022/02/Harbor_Life_Settlements_Whitepaper.pdf

Once the required number of life expectancy analyses have been secured, the medical records and life expectancy certificates are sent to 20-30 life settlement purchasers. Typically, each potential purchaser knows what it's looking for in a policy based on its preferred investment approach, but valuation is a key part of the life settlement process. For example, in our case study above, the initial offer and the final offer varied by over $400,000. Such gaps in valuation, when extrapolated on a portfolio-wide basis, clearly can be material to a fund's performance. Upon offer acceptance, the investor will provide the policyowner and insured with a purchase agreement.

The Role of State Law

The entire life settlement process is governed by state insurance departments, specifically the state where the policyowner resides. The purchase documents must be reviewed and approved by the state governing the specific transaction. While at first glance the documents appear cumbersome—similar to that of a mortgage—it is important to know that state insurance departments have gone to great lengths to protect the policyholder in these transactions. Note that in most states there is a recission period that begins when the money is wired from the settlement provider to the policyowner. In the event someone has a change of heart or the insured passes away during the recission period, the original rights of the policy will go to the owner.

Policy Characteristics and Types

Understanding the terms and conditions that attach to the underlying insurance policies is a key to success when pursuing a life settlement investment strategy. Ideal sellers have a life expectancy of less than 18 years but over two years with 10 years serving as the median (a viatical settlement is the sale of a policy on a person whose life expectancy is less than two years). Insureds are typically over 65 years old, with 77 serving as the average. If an insured incurs a change in health from the date of policy issuance to present day, this is favorable for the establishment of fair-market value of the policy. As previously mentioned, this is an inverse process from when the policy was first established.

Universal life, whole life, variable universal life, guaranteed universal life, indexed universal life, and term insurance are all candidates to be purchased in the life settlement market. In most cases, term insurance will still need to have conversion options available. Overall, in this market, underfunded or underperforming universal life policies seem to be most appealing to potential purchasers. Term insurance is also attractive because generally the purchaser can convert the term insurance to the product of the buyer's choosing. All other types of policies can be sold, but the cost of insurance can be higher than those previously mentioned.

Taxation of Policy Proceeds

As with any investment or transaction, the way proceeds are taxed can have a huge impact on the underlying economics of the deal. As set forth under the 2017 Tax Cuts and Jobs Act, the tax treatment for a life settlement is as follows:

- Up to Basis (premiums paid into the policy)—No Tax Consequence
- Basis to the Surrender Value—Ordinary Income
- Sale Proceeds exceeding Surrender Value—Capital Gain

Most settlement transactions typically only involve capital gains because it is uncommon to see a universal life policy with a surrender value in excess of basis. When the total premiums paid into a policy exceeds the settlement value, there is no tax consequence to the seller.

Conclusion

The life settlement process is a very valuable mechanism for certain insured and potential buyers to mutually benefit from the transaction; however, it may be underutilized due to a lack of awareness or full legal understanding of the related implications. Involving experienced advisors from a legal and life insurance standpoint can significantly reduce the amount of risk compared to potential reward in these situations. In addition, the industry's regulatory standards add an extra level of transaction risk that investors will need to navigate. ▲

Momentum Continues Despite Recent Headwinds
MICK 2022 Oil & Gas Report – E&P

By Mick Law P.C.

Mick Law P.C. is a specialty firm comprised of full-time and of-counsel attorneys who each possess a concentrated area of expertise and in-depth knowledge. In addition to their law school credentials, the attorneys also have professional and educational credentials, including MBAs, LLMs, and securities industry licenses. While providing a broad range of legal services to our valued clients, the firm focuses on two principal areas of practice: broker-dealer and register investment advisor representation and real estate finance.

Despite the headwinds from the left side of our federal government seeking to impose the green agenda to displace fossil fuels with more carbon-friendly sources (i.e., solar and wind), the U.S. E&P sector managed to hold its own in 2022 in terms of business growth, which was demonstrated through a year over year increase in onshore drilling activities, as well as a gradual increase in U.S. daily oil/gas production. As a result, oil/gas exploration and production ("E&P") capital raising within the retail financial sector saw a significant up-tick in 2022.

As was the case prior to COVID (2020), the fortunes for the E&P sector remain on a roller coaster ride into 2023, as oil prices, which reached $130 per barrel (bbl) in May 2022 and have settled into a more stable pricing pattern (i.e., $77 bbl WTI, Feb. 8, 2023). As to the prospects for natural gas, prices in the short term have fallen from the prices observed through much of 2022 due to a pattern of unseasonably warm weather. On a cautious note, natural gas storage levels come March 2023 will likely test domestic U.S. gas prices through much of this year, which hinges upon whether the warmer weather stays from now until April. Notwithstanding, the need for U.S. natural gas abroad on a long-term scale should help to present opportunities for better pricing into 2024 and future years (i.e., due to a gradually increasing capacity to export gas to Europe, as well as the effects of the lingering Russian-Ukraine conflict that could affect gas supplies into 2024).

Energy Sector Capital Summary

In 2022, we covered thirteen (13) companies which operate within the upstream sector of the energy value chain. This group collectively funded 22 private placement programs and raised $1.093 billion to support drilling and infrastructure, mineral rights acquisitions, and related E&P initiatives/projects within the retail investment channel. This represented a 96% year over year increase in private capital funding from what was reported by these companies in 2021 (i.e., ten sponsors, $555.974 million). This also resulted in the highest capital raise year from the E&P sponsor group that we cover since 2014.

Leading the way in terms of fundraising was U.S. Energy Development Corp. ("U.S. Energy"), at $332.68 million, which was followed by Mewbourne Development Corporation ("Mewbourne"), at $250.0 million, and MDS Energy ("MDS"), at $225.0 million. In terms of funding growth, eight of these sponsors reported year over year gains in fundraising, which helped to continue their capital raising momentum established in 2021 after the headwinds of the pandemic began to dissipate (i.e., with $273 million being the capital raise from the E&P group in 2020 during the pandemic year). A chart of the fundraising totals of the E&P sponsors we covered is provided below:

Table 1 - Capital Raised

Company	Strategy	2022 Raise	2021 Raise	2020 Raise
Mewbourne	Drilling-horizontal wells in the Permian Basin, Texas Panhandle, and Anadarko Basin	$250.00 MM	$119.80 MM	$55.31 MM
MDS	Drilling-horizontal wells in the Marcellus Shale Play	$225.00 MM	$146.919 MM	$60.0 MM
APX	Drilling-vertical Mississippian oil targets in the Illinois Basin	No raise 2022	$19.0 MM	$12.0 MM
S.T.L.	Drilling- horizontal wells in the Marcellus Shale Play	$42.50 MM	$29.5 MM	$17.3 MM
U.S. Energy	Drilling-horizontal drilling in the Permian Basin, Powder River, and Eagle Ford Shale Plays; the QOF is also an opportunity fund seeking working interests and other upstream assets program	$267.93 MM drilling; $56.65 MM QOF; $8.10 MM 1031	$145.0 MM drilling; and $45.0 MM QOF program	$64.0 MM drilling; and $20.0 MM QOF program
Waveland	*Opportunity Fund* targeting minerals and non-operated working interests in the Bakken Shale Play	$42.64 MM	$13.255 MM	$22.0 MM
Resource Royalty	*1031 Programs* acquiring minerals and royalties in STACK Play of Oklahoma	$32.9 MM	$11.067 MM	$5.373 MM
Montego Minerals	*1031 Programs* acquiring minerals and royalties in the Permian Basin and East Texas	$62.20 MM	$19.730 MM	$12.5 MM
JHO	*Drilling*-shallower vertical oil zones in Tennessee	$5.00 MM	$6.704 MM	$4.35 MM
White Hawk Energy	*Royalty Fund* acquiring mineral rights, royalties, and overriding royalties	$65.70 MM	NA	NA
Barrow Shaver Resources	*Drilling*-horizontal wells in the E. Texas Bossier and Cotton Valley Plays	$4.50 MM	NA	NA
Texakoma Resources, LLC	*Drilling*-horizontal wells in the Granite Wash Play in Texas	$30.00 MM*	$20.00 MM	$15.00 MM

**Texakoma Resources raised capital through its captive broker-dealer for drilling within its one-well program platform in 2020-22; this sponsor will resume its launch of a diversified program platform in 2023.*

2022 E&P Capital by Strategy

Total Capital:	$1,093,340,000
Contributing Sponsors:	12[1]
Drilling:	$824,930,000 (75%)
Opportunity Funds:	$99,340,000 (9%) (includes a QOZ fund)
Minerals /Royalties:	$168,900,000 (16%) (61% structured as direct interest)

Nine Internal Revenue Code ("IRC") 1031 eligible programs were wholly or partially funded in 2022 by Resource Royalty, Montego Minerals, and U.S. Energy. Overall, the §1031 energy program capital in 2022 ($103.20 million) increased from what was reported in 2021 ($31 million) and 2020 ($18 MM). Driving this upward trend in 1031 capital was the doubling of 1031 eligible offerings last year (i.e., nine offerings funded in 2022 vs. five in 2020), which was fueled by better oil/gas fundamentals coming out of COVID, as well certain acquisition related opportunities that have surfaced from the movement within the public E&P sector to monetize non-operated drilling location assets in response to ESG, as well as Wall Street's expectations in general (i.e., with shareholders placing pressure on companies to use cash flows to pay distributions as opposed to enhancing drilling budgets). Based upon current oil market fundamentals and perhaps ***longer-term*** natural gas pricing due to anticipated LNG export growth, this E&P sponsor group appears to be fairly positioned to achieve a respectable volume of capital raising in 2023 and 2024.

We note that the size of the E&P sponsor group that we cover has been stable over the past couple of years (e.g., ten to twelve sponsors in 2017-2022), with drilling programs outpacing royalties and opportunistic funds in terms of fundraising. Due to the numerous pricing cycles we have dealt with, the fundraising of this sponsor group has been incredibly choppy since 2017 ($330 MM 2017, $401 MM 2018, $369 MM 2019, $273 MM 2020, $556 MM in 2021, and $1.1 billion 2022). This choppiness was caused by multiple headwinds that included severe market volatility, coupled with the fact that the sector continues to seek the reestablishment of investor trust that was lost because of performance failures by several companies that no longer raise capital in the retail channel. Based upon current oil market fundamentals in the near term, as well as longer term natural gas fundamentals, the E&P sponsor group appears to be reasonably positioned to maintain its momentum going into this year.

Alternative Energy Side Note

Representing the other side of the energy value chain, e2comply, LLC ("e2C") entered the retail broker-dealer channel in late 2020 and raised approximately $90 million from accredited investors in 2021 and 2022 pursuant to its senior secured bond offering, as well as an additional $28.50 million in 2022 from its Series B preferred share offering. The proceeds from these offerings are expected to be used by e2C to help fund its manufacturing of back-up power systems that enable certain companies that require power on a 24-7 basis (e.g., hospitals, utilities, bakeries) to function on a continuous basis, while also allowing such companies to run the back-up system at times when it is cost-effective to do so (which helps the consumer businesses to save money on their monthly power costs). Driving the appeal of e2C's offering, in part, was the Texas power crisis of 2021, which was caused by a winter storm that caused the state's electric grid operator to lose control of the power supply, leaving millions of people and many businesses without access to electricity. Subject to ongoing due diligence in 2023, e2C appears to be positioned to continue momentum with its capital raising efforts this year.

What's Driving the Market Today?

The following market information was derived from multiple informational sources:

Oil

As of February 7, 2023, the WTI spot price for oil was $76.68 per barrel ("**bbl**") of oil, with the Brent spot price being $83.29 per bbl. The Energy Information Administration ("**EIA**") forecasts WTI spot prices to average $83 per bbl in 2023, **but with the EIA's estimate for 2024 dropping to $78 per bbl.**

Within its Short-Term Energy Outlook ("**STEO**") published in January 2023, the EIA reported a measure of stability in terms of oil supply and demand, with oil consumption worldwide (99.40 million bbls day) generally keeping pace with worldwide production (99.98 million bbls day). While the EIA anticipates oil prices to fluctuate from $75-85 bbl in 2023 and 2024 because of moderate consumption growth (102.80 million bbls per day estimated for 2023), the EIA has also acknowledged the concerns within the energy markets about global economic conditions and the pace in which China will continue to ease its COVID restrictions.

Domestically, the EIA reported in its January STEO that U.S. oil production reached 12.40 million bbls a day in October/November 2022, the most in any month since March 2020. The EIA expects that that oil production will average 12.40 million bbls per day in 2023 and 12.80 million bbls per day in 2024, which if attained would bring the U.S. E&P sector back to its production levels achieved prior to the onset of COVID in early 2022. **This rising trend in U.S. oil production is part of the thesis for the EIA's belief that oil inventories will keep pace with the moderate increase in world oil consumption this year and next.**

The EIA's oil pricing sentiment runs parallel with a pricing survey conducted by Reuters in December 2022. Reuters' survey of 30 economists and analysist forecasted that Brent Crude will average $89 bbl in 2023, thereby suggesting that oil prices may very well fall within a general range of $70-85 bbl on WTI in 2023 (i.e., due to a historical pricing spread of about 5-10%). Again, a darkening global economic backdrop fueled by COVID flareups in China, coupled with inflationary pressures in the U.S. and elsewhere will probably test such prices at times throughout 2023 and going into 2024. The magnitude of such uncertainties is exemplified within the U.S. futures market, which anticipates lower prices going into the next couple of years.

February 6, 2023

NYMEX Contract Month	Contract Price
Mar. 2023	$74.74/bbl
Sept. 2023	$74.11/bbl
Mar. 2024	$71.85/bbl
Mar. 2025	$68.10/bbl
Mar. 2026	$65.20/bbl

In his market report shown on February 2, 2023, Dan Steffens, President of the Energy Prospectus Group, presented a number of circumstances suggesting that oil/gas will continue as the predominant sources of world energy from now through 2050. While estimating the renewable sector's share of the world energy market will grow from 15% in 2020 to about 27% in 2050, the intermittency of solar/wind, couple with the need for fossil fuels as a supporting energy source for solar/wind infrastructure is expected to result in moderate consumption growth for all fossil fuels over the next 30 years. A chart illustrating oil/gas' estimated place within the world's energy value chain over the next 30 years is shown on the following page.

Quadrillion BTU Consumed Worldwide

Energy Source	2020	2030	2040	2050	CAGR 2020-2050
ALL	602	705	795	886	1.30%
Renewables	89	136	184	235	3.30%
Nuclear/Biofuel	45	52	56	56	0.60%
Coal	156	156	168	177	0.40%
Natural Gas	147	166	178	193	0.90%
Crude	165	195	209	225	1.0%

Sorce: EIA 2023

Natural Gas

On February 7, 2023, the natural gas spot price at Henry Hub was $2.60 per mcf, which is down considerably from the 2022 average of $6.45 per mcf. The drop in natural gas prices was occasioned by multiple headwinds that included (i) an unseasonably warm winter in the U.S., as well as (ii) a recent movement by the Biden administration and the U.S. Consumer Product Safety Commission to ban natural gas stove sales. The Biden administration's attack on natural gas stoves came about because of a research report published in December 2022 suggesting that 12% of childhood asthma cases in the U.S. can be attributed to natural gas stove use (but with Senator Joe Manchin and other Republican leaders vehemently contesting such findings in D.C.).

As a result of the above-mentioned headwinds, the EIA anticipates that the Henry Hub spot price will average $3.40 per mcf in 2023, down almost 50% from last year. Despite this, longer-term fundamentals for natural gas are more promising as the U.S. ramps up its liquid natural gas ("**LNG**") exporting capacity. On an international level, the EIA reports that the U.S. has become a leading exporter of LNG, which averaged 11.20 bcf per day through the first half of last year. On this point, Reuters reported in December 2022 *"... that U.S. LNG exporters boosted shipments to Europe by more than 137% in the first 11 months of 2022 from the same period in 2021, thereby supplying more than half of Europe's imported LNG and helping the region weather a more than 54% plunge in piped shipments from Russia."* As reported by Reuters, the U.S. appears positioned to remain Europe's top LNG seller in 2023, as U.S. exporters have greatevolumes of LNG available for spot market purchases than other major exporters.

Strip February 6, 2023

NYMEX Contract Month	Contract Price
Mar. 2023	$2.56/mcf
Sept. 2023	$2.64/mcf
May 2023	$2.79/mcf
June 2023	$2.97/mcf
Mar. 2024	$3.75/mcf
Mar. 2025	$4.03/mcf
Mar. 2026	$4.08/mcf
Natural Gas price average —past five years	
2018	$3.15/mcf
2019	$2.58/mcf
2020	$2.03/mcf
2021	$3.89/mcf
2022	$6.45/mcf

What's Going On in the Field?

In November 2022, U.S. oil production was 12.375 million bbls per day, which was 1.0 million bbls per day more than what was reported in January of last year. Despite this significant growth in our daily production, oil prices have managed to rebound from a two-year low of $65 per bbl (December 9, 2021) due to the resurgence of oil consumption across the globe. This increase in domestic production is further reflected by a higher U.S. rig count, which has increased from 392 rigs running in February 2021 to 745 rigs running currently.

Basin	Feb. 3, 2023 Rig Count	Feb. 2022 Rig Count	Feb. 2021 Rig Count	Jan. 2020 Pre-COVID
Arkoma/Woodford Region	32	26	9	23
Barnett Shale	2	2	1	2
DJ-Niobrara	16	12	5	20
Eagle Ford Shale	72	50	28	67
Granite Wash	9	5	0	1
East Texas & Haynesville Shale	69	54	47	49
Marcellus Shale	37	33	30	40
Mississippian Play	4	1	0	2
Permian Basin	354	294	198	403
Utica Shale	15	12	7	11
Williston Basin/Bakken	42	31	12	52

Baker Hughes, 2/3/23, 2/4/22, 3/6/21

On a positive note, oil drilling has increased to various levels within ten of the eleven oil/gas basins covered by Baker Hughes' data. The major U.S. basins that have experienced the most growth from a year ago include the Eagle Ford (up 44%), Permian (20%), Granite Wash Play (80%), and Bakken Play (35%). Certain natural gas producing areas have also managed to hang on to some of the momentum from 2022, as evidenced by the rig counts within the Arkoma/Woodford (up 14%), Utica (up 20%), and Marcellus Play (up 12%).

Motivation to Drill—What are the Break-Evens?

Despite the market fundamentals for oil in 2023-24, a stable market commands a world supply/demand balance. Against this backdrop, today's oil market fundamentals present opportunities for U.S. E&P companies to continue their profits into this year by increasing their drilling. An illustration *"suggesting"* how much profit can potentially be achieved by oil/gas producers is shown in the following table (with break-evens reported on a "**per bbl**" basis):

Break		
Play	Avg. Break Even Drilling	Avg. Price to Recover Op. Costs
Permian-Midland	$51	$29
Permian-Delaware	$50	$28
Permian-Other	$54	$33
Eagle Ford	$48	$23
Other U.S. Shale	$60	$35
Other U.S. Non-Shale	$69	$38

Federal Reserve Bank of Dallas survey. Report updated Jan. 12, 2023.

Based upon the findings of a survey published by the Federal Reserve Bank of Dallas (Dec. 29, 2022), many E&P companies are, in fact, gearing up to increase their drilling over the next 12 months. Within a survey of several executives from 149 oil/gas drilling and field service companies, the average forecasted oil price for year-end 2022 was $73 per bbl, with the group of executives predicting natural gas to end the year at $5.93 per mcf. Coincidentally, and based upon their viewpoints about oil/gas prices, 64% of the executives from the 148 surveyed companies stated that their companies intend to increase their cap. ex. spending over the next 12 months, with another 22% also stating their plans to maintain their present cap. ex. spending levels. Of 90 surveyed drilling company executives, the three biggest perceived headwinds to increasing their oil/gas production in 2023 are (i) drilling cost inflation, (ii) maturing asset bases, and (iii) capital availability. *While acknowledging that there are forces that might serve to temper the E&P sector's motivation to drill (e.g., the Biden administration's disdain for the sector),* **money continues to talk.**

Market Volatility—Revisiting Where We Have Been

It goes without saying that the past 20 years have been a roller coaster ride for oil/gas prices, as we have seen oil as high as $140 per bbl (July 2008) and as low as negative $37 per bbl (April 2020). While bull markets are a welcomed development for those that guide investors seeking to put money into the E&P sector, history teaches us that we need to be disciplined in terms of our return expectations. The cycles of the past several years can be summarized as follows:

- A floundering real estate market in 2007-2008 due to the sub-prime loan market collapse motivated many in the financial services sector to move money from real estate to crude, which drove oil prices to $140 bbl in July 2008. However, the Great Recession that hit in late 2008 dropped oil back to $30 bbl before a recovery to $60-80 bbl occurring late 2009/2010.
- The shale boom that took U.S. oil production from under four million bbls oil per day in late 2008 to more than nine million bbls per day in 2014 over-supplied the global market. Saudi Arabia's failed attempt to regain market share in 2014 caused the oil price to decline from over $100 per bbl to under $30 per bbl. The double bottom in early 2016 appeared to be the end of this cycle, and oil moved back over $70 per bbl in the summer of 2018.
- The U.S. vs. China trade war took oil back under $50 per bbl. The signing of phase one of the trade agreement had oil back on track to the $70s. In the first week of 2020, oil was trading over $62 per bbl, and everyone thought the price was heading higher.
- Then came COVID and the oil crash in April 2020. From April through the first week of May, we saw prices settle below $20 bbl and even dip below $0 for a day.
- COVID began to loosen its grip on world economies in 2021, which caused the world's appetite for crude to resume significantly. This caused worldwide oil consumption to spike from 91 million bbls day in 2020 to 97 million bbls day in 2021, yet oil prices moved back to an $80-90 bbl level in January 2022.
- The Russian-Ukraine crisis escalated in earnest in February 2022, sending oil prices soaring above $130 bbl, and with the perception of constrained natural gas supplies also causing prices to average $6.45 mcf last year.
- Finally, the balancing of world oil supply/demand results in oil prices returning to a more stabilized level in January 2023. Unseasonably warm weather, coupled with pressure from the Biden administration to curb sales of natural gas stoves also resulted in natural gas prices dropping below $3 per mcf in early February 2023.

Despite the rhetoric in the press, White House and on Wall Street about renewable energy displacing crude as the world's chief source of energy, the world's need for crude as a viable energy source remains steadfast. That said, we MUST not forget the inherent volatility risks associated with oil/gas commodities, and how that has played to the chagrin of many public and private E&P companies over the past several years that over borrowed and eventually collapsed.

The Need to Stay Disciplined With Your E&P Due Diligence

Despite some welcomed optimism about the prospects of oil (currently) and natural gas (longer-term, late 2023 and 2024), we must remain steadfast in our underwriting of oil/gas companies, because no one is immune to the next pricing cycle. As such, we must pay attention to break even prices and the break points whereby an E&P sponsor's pro forma becomes unprofitable. As cap. ex. and lease operating costs have increased by 50% and greater in many areas as a result of recent oil pricing trends, we must stay the course in the quest for sponsors and products that have the best possibilities for success under less fortunate circumstances. **As we have written in our past year-end reports, stay committed to cautious due diligence. As history has taught us, the next cycle will come—we just don't know when.** ▲

Due Diligence Considerations: the Continuum from Conflicts of Interest to Alignment of Interests

By Julie Olsen, *CFA, MBA, FactRight*

Before joining FactRight in 2021, Julie spent over a decade providing due diligence to small independent broker-dealers, primarily focusing on non-traded REITs, non-traded BDCs, and Reg D private placements. She brings the broker-dealer long-term perspective along with her analytical, innovative, and continuous improvement mindset to drive quality.

Alternative investments programs involve many conflicts of interest, and offering documents often have an entire risk disclosure section dedicated to this issue. But not all conflicts are the same and vary by product and sponsor. Assessing conflicts really come down to two central questions:

- **How are conflicts managed?**
- **How are interests aligned?**

Assessing existing and potential conflicts is important because an investment will become a long-term relationship that the investor may not be able to exit early or without incurring redemption penalties. Many offerings are written to provide the sponsor/affiliates with significant discretion to make decisions that impact investors' returns and time horizon. This is not necessarily a bad thing because it provides the sponsor flexibility to manage the program. Often, the sponsor has the ability to:

- change the investment policy, target leverage, distributions, redemption program, etc.
- approve valuations, affiliated transactions, reimbursable costs, when to implement an exit strategy, etc.

In a perfect world, there wouldn't be any conflicts, and the fund's performance would match the model's forecast. However, over a long-term hold, there's a good chance that market conditions change outside of the manager's control, and reality differs from the model's assumptions.

Assessing how a sponsor approaches conflicts of interest can fall on a continuum from disclosing conflicts, to avoiding conflicts, to pursuing alignment. From left to right, this continuum increases the level of benefit to investors and effort to implement.

A *conflict of interest* arises when a sponsor/advisor/manager can use their position of power and trust for their own benefit, or the benefit of another pool of investors, which may be at the expense of investors of a particular program. Common examples of conflicts of interest include:

- Allocation of management's time and resource among funds and business lines
- Allocation of investment opportunities among funds
- Related party transactions (see Kemp Hanley's blog post: How to Assess Affiliated Transactions in Private Placement Programs)
- Back-end splits that incentivize sponsors to increase the risk to investors
- Incentives to grow assets under management when capital can no longer be deployed efficiently
- Business model that relies on transaction fee revenue, which can lead to a sales culture
- Business model that relies on AUM, which can disincentive a liquidity event

The goal is not to eliminate conflicts. Some level of conflict is unavoidable because mitigating one conflict may create a different conflict. For example, if the asset management fee is based on the valuation of investments and management is responsible for determining the valuation, then management may be incentivized to choose aggressive valuation assumptions. If the asset under management fee is based on cost, then the sponsor may be incentivized to quickly deploy capital rather than focus on long-term performance.

Rather than eliminate conflicts, the goal should be to balance conflicts and create alignment based on the facts and circumstances.

Alignment of interest is an arrangement that provides a win/win so that all parties benefit from a particular target outcome under various market conditions. If everything goes according to plan, then the result should be win/win. But when things don't go according to plan, the additional gain or loss should be shared. This means that the additional gain or loss should not benefit just the sponsor or just the investor. It should provide the sponsor with sufficient compensation to implement the fund strategy and reward it for achieving results in line with the sponsor's role in achieving the result.

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Trends in Industry Standards

Professional codes of ethics within the alternative investment ecosystem seem to support moving the minimum standard from disclosure to avoidance of conflicts. It is also a sensitive regulatory topic for broker-dealers.

Professional associations such as the *American Institute of Certified Public Accountants (AICPA)* and *Chartered Financial Analysts (CFA) Institute* cover conflicts of interest in their codes of ethics to maintain and enhance public trust. They recognize responsibilities to different stakeholders including both clients and the general public. Both organizations cover similar principles such as professionalism, integrity, due care, and independence and objectivity. The implication is that members of the AICPA and CFA Institute that serve as part of sponsor management teams and board of directors should be held to high ethical guidelines in carrying out their professional duties.

The AICPA is a volunteer organization for CPAs in the United States. The *AICPA's principles of professional conduct* address conflicts of interest under objectivity and independence. It states:

> *"A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services… In providing all other services, a member should maintain objectivity and avoid conflicts of interest."*

AICPA members who practice public accounting are held to the standard of avoiding conflicts of interest in both fact and appearance. While members not in public practice cannot eliminate conflicts of interest, they are still held to other standards such as public interest, integrity, and due care.

CFA Institute is an international organization for financial professionals. The *Code of Ethics and Standards of Professional Conduct* was last updated in 2014 and is in process of being updated. The comment period for the draft recommendation is open through March 6, 2023, and there is a proposed change for conflicts of interest. Currently, the standard is to provide full and fair disclosure of conflicts of interest. However, the draft update states:

> *"Avoidance and Disclosure of Conflicts of Interest. Members and Candidates must, **when feasible, avoid** all matters that could reasonably be expected to impair their independence and objectivity and interfere with their duties to clients, prospective clients, and employer."*

Under the proposed change, the standard would be moved from disclosing conflicts of interest to avoiding conflicts of interest.

Regulators have also been focusing on this topic. Historically, disclosure of conflicts of interest was sufficient to meet SEC requirements. That changed with Regulation Best Interest (Reg BI), which became effective June 30, 2020. Reg BI requires broker-dealers, registered representatives, and associated persons to act in the best interest of retail investors when making investment recommendations. Reg BI includes four component obligations: disclosure, care, conflict of interest, and compliance. The SEC updated *Staff Bulletin: Standards of Conduct for Broker-Dealers and Investment Advisers Conflicts of Interest* on August 3, 2022, and "conflict(s) of interest" appear 89 times. The bulletin discusses identifying conflicts, examples of conflicts, obligation to eliminate conflicts when appropriate, ways to mitigate conflicts, and disclosing conflicts.

Source of Conflict of Interest

In order to avoid conflicts of interest, first we need to understand that conflicts can come from people, structure, and time.

Individual Motivations

At the most basic level, conflicts of interest raise the fundamental question: will management act in the best interest of investors?

- **Bad actors.** Worst-case scenario, management is so motived by greed and/or ego that the sponsor will resort to fraud and deception to benefit themselves at the expense of investors.
- **Owners vs. management**. If the sponsor's owners are not involved in the sponsor's day-to-day business, ownership may be more focused on distributing profits from the sponsor, which could prevent management operating the business in a way that makes sense on a long-term basis. For example, the business model might rely on transaction revenue to support operations, forcing management to focus on short-term results.
- **Employee compensation incentives.** People responsible for implementing the investment strategy might not be incentivized to deliver results for investors. For example, if the head of acquisitions receives a bonus based on transaction volume, then that person would be motivated to increase the number of transactions regardless of the forecasted risk/return to investors or the operational burden to the asset management team.

Sponsor Structure

Even when people want to do the right thing, structural factors may incentivize people in ways that conflict with investors interests.

- **Culture.** Sales-driven organizations tend to take a more short-term view than organizations focused on long-term results. For example, a sales-driven culture might focus on raising capital even when the sponsor can no longer deploy it efficiently.
- **Oversight.** If the sponsor is wholly owned by a single manager, then the sponsor might not have a governance structure in place the provides accountability. The owner's success could lead to arrogance and unwillingness to implement best practices that protect investors.
- **Business focus.** Sponsors might have affiliated entities that provide services along the supply chain. For example, if a real estate sponsor owns a property management company, this could create incentives to acquire properties in locations based on where the property manager's regional manager has capacity. Or the sponsor might engage the affiliate at less attractive terms compared to a third-party property manager. However, vertical integration can also provide the sponsor with a competitive advantage.
- **Investor base.** The sponsor might source capital from multiple types of investors, including institutional investors, foreign investors, and retail investors. If retail investors represent a small portion of their overall assets and revenue, the sponsor may favor programs funded by its other investors.
- **Differing levels of skin in the game.** Sponsors might have different levels of co-investment for different product offerings. If a sponsor co-invests 30% on an institutional fund and 1% on a retail fund of equal sizes, the sponsor will be incentivized to allocate more attention to ensuring the success of the institutional fund because more of their capital is at risk.
- **Products lines.** The sponsor might offer different investment strategies or follow-on products that compete for resources or investment allocation. For example, a sponsor with value-add funds and stabilized funds may be incentivized to sell a value-add property to the stabilized fund once the asset has been stabilized.
- **Sponsor profitability.** Since performance fees are tied to fund-level performance, then the sponsor will earn more on successful programs. If the sponsor manages two similar funds with one performing well and the other performing poorly, management might focus its efforts on the one performing well in order to maximize total performance fees.

Fund-level Structures

- **Fund-level fee structures.** Funds often have various fees, including transaction fees (e.g., acquisition, loan-origination, refinance, development, leasing, disposition, etc.), recurring fees and costs (e.g., asset management fee, administrative fee, expense reimbursement), and performance-related fees (e.g., annual performance fee, back-end split). If a fund isn't performing well enough to earn performance-related fees, then the sponsor may be incentivized to continue to hold properties so it can continue earning recurring fees. Also, if governance documents allow reimbursement of sponsor overhead, including of management and employee wages, then management fees may become a profit center to the sponsor.
- **Fund-level legal structure.** There are different rules for different types of investments (e.g., non-traded REITs vs. DSTs). For example, DSTs do not have performance fees and cannot commit the seven deadly sins without consequence. This may encourage sponsors to shorten the holding period (e.g., two five-year DSTs over 10 years) so they can show positive returns and redeploy capital into a new DST to harvest more transaction fees.

Time

- **Sponsor lifecycles.** New sponsors have different motivations than established sponsors. A new sponsor needs to build relationships and establish a track record. Since new sponsors may not have significant assets under management, they will be incentivized to generate transaction fee revenue in their early lifecycle to cover operating expenses. On the other hand, large established sponsors may have more affiliated entities that provide services to the fund, resulting in conflicts from related party transactions.
- **Growth in AUM.** As sponsors become established, they often rely more on asset management fees to cover most of their operating expenses. This may incentivize the sponsor to extend the holding period of a fund.
- **Management composition.** It's fairly common to have some management turnover over a fund's holding period. New members of the management team may have different motivations or core competencies compared to the management team in place when the offering was issued.
- **Business model.** As a sponsor grows, it might build out business lines to support vertical integration. For example, a real estate sponsor might create a property management company or development company. If these different business lines generate better profit margins or have significant fixed costs, the sponsor may allocate more resources to grow and sustain these areas and/or cause the investment funds to enter into affiliated transactions that may or may not be in the best interest of the fund.
- **Strategy.** A sponsor that has traditionally focused on real estate might shift its strategy from one

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sector to another. If the sponsor wants to show success in the new strategy, it might devote more time and energy to creating a resumé piece and less effort on managing an existing fund.

- Market environment. Over a long-term hold, it is likely market conditions will change. The sponsor may need to cut back on overhead costs, which could adversely impact resources needed to manage existing funds, and/or pursue new business strategies.

Assessing conflicts of interest

Assessing the level of conflicts of interest versus alignment of interest is not a check-the-box exercise. It requires a wholistic and subjective view of the sponsor and the product.

Here are questions to consider:

- Who are the stakeholders? Who has authority to make decisions that impact the performance of the fund? What are their motivations? How are they compensated?
- How involved are the owners? What is their level of commitment to the long-term success of the sponsor or affiliated entities? How much capital have they contributed? How do they distribute sponsor profits to themselves?
- How open is management to receiving and incorporating constructive feedback to improve alignment of interest with investors?
- Does the sponsor or the fund(s)have independent boards? If so, how much of an overlap is there in directors across funds? How are directors chosen? What are their qualifications? Do they have a fiduciary duty? What professional code of ethics govern their behavior?
- Who is on the executive management team? What is their experience? What professional code of ethics govern their behavior?
- What is the sponsor's culture? What are its core values? How does it demonstrate those values? Is it focused on short-term profits or long-term results? How does it define success? What types of internal controls does it have in place? What type of transparency does it provide to investors? What types of industry best practices does it follow?
- What is the sponsor's business model? How much do they rely on transaction revenue, assets under management fees, and performance related fees? How much of their expenses are fixed verses variable?
- How does performance align with results? Do performance fees have a hurdle or catchup provision? Is the hurdle appropriate for the amount of leverage and risk? Can the sponsor increase leverage? What has the sponsor done in the past?
- How much does the management team co-invest into the fund, both as a percentage of the fund size and how much relative to their personal wealth? Are the terms pari passu? If not, is it adequately disclosed and are the different terms reasonable?
- Does the fee structure fit the investment objectives of the fund? Is the fee structure outside of industry norms? Are fees relatively consistent across the sponsor's funds?
- How has the sponsor managed funds through difficult market cycles? Does the structure provide flexibility for the sponsor to waive or defer fees?
- Is the asset management fee based on cost or estimated market value? If estimated market value, how is the valuation determined?
- How are distribution rates set? Has management increased their compensation while distributions were suspended? Are the sources of distributions adequately disclosed? Is there a reasonable plan to cover distribution from operating cash flow?
- What level of accountability does management have to investors? Can investors redeem their investment at reasonable terms? How easy or difficult is it to remove the manager? What rights do investors have? How reasonable are those rights? How reasonable or prohibitive are the conditions to exercise those rights?

Pursuing Alignment

Since the sponsor structures and manages the funds, the investment community can focus on sponsors and products that seek to minimize conflicts and try to create alignment when possible.

Sponsors that try to align their interest with investors should have the following characteristics:

- Owners and managers are committed to a long-term business plan that can sustain through difficult market conditions.
- Members of the management team make meaningful co-investments at terms that are pari-passu with investors.
- The sponsor has a culture of seeking out and implementing best practices around functions such as governance, operational control, employee compensation, etc.
- Fee structures and reimbursement across all funds provide fair compensation so the sponsor can operate but receive profit based on performance.
- The sponsor operates funds with a reasonable level of transparency, independence, and objectivity (e.g., benefit to the fund outweighs the audit and third-party valuation costs).
- Funds are structured to provide fairness to investors through reasonable redemption programs for the investment focus and fund structure, timely and transparent performance reporting using appropriate performance measurements, and appropriate investor rights that provide accountability from management.

Key takeaways

Since illiquid alternative investments have a long-term commitment, it is important to invest with sponsors that you trust to manage conflicts appropriately over the holding period. For all sponsors, look at the people, structures, and potential impacts of change over time. For new sponsors, pay close attention to how they structure a deal to avoid conflicts of interest and how they incorporate feedback to create better alignment of interest. For established sponsors, pay attention to the actions they took during a challenging period and what has changed since that time.

My hope is that sponsors that seek to create alignment will provide better long-term results for investors and enhance public trust in the industry. ▲

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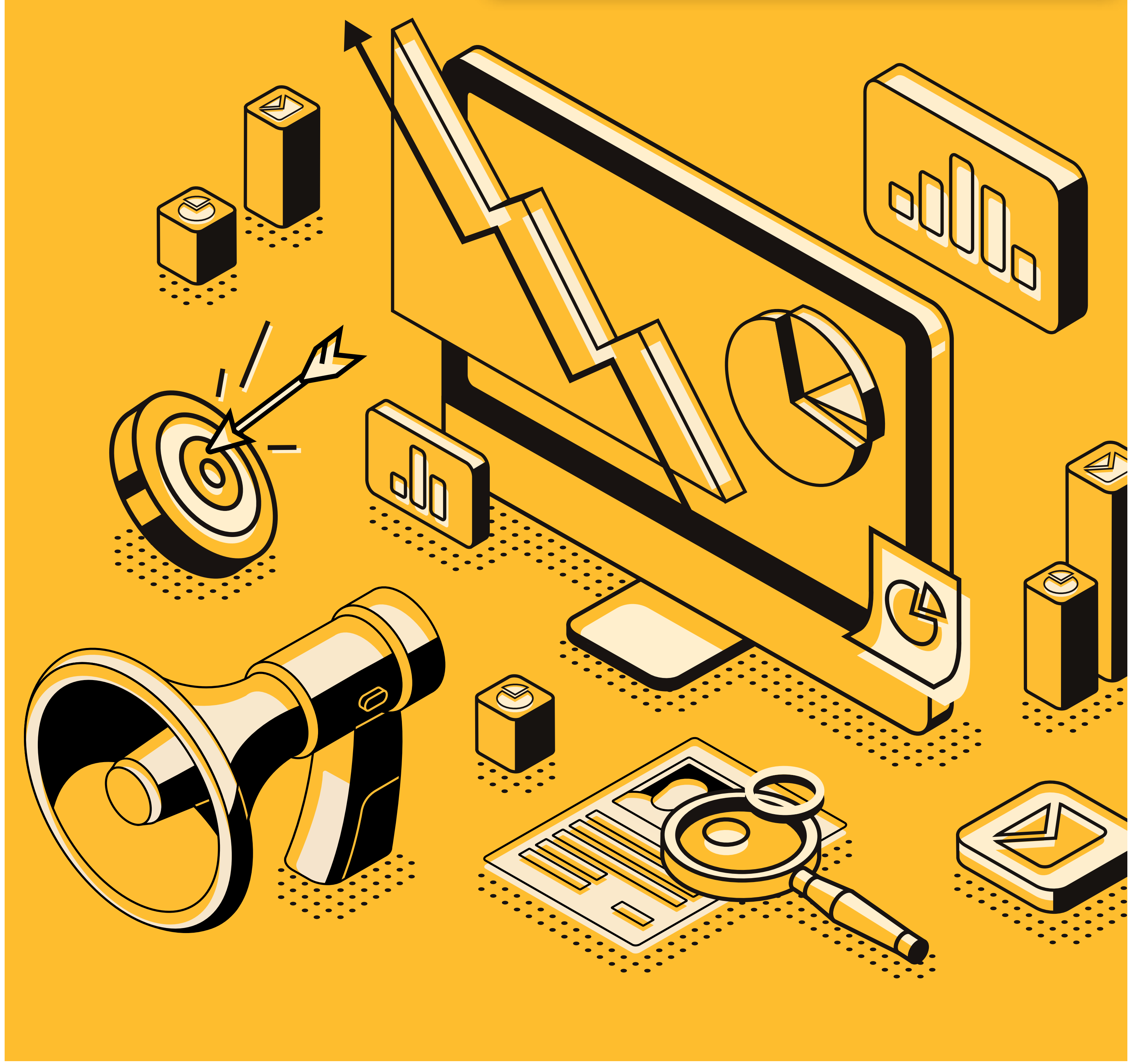
How Advisors Evaluate Sponsors on Marketing & Communications

By Cherie Fournier, *CEO/Founder, Marketing Intent*

About Marketing Intent

We are a sales-focused marketing group specializing in alternative investments. We help asset managers raise capital and bridge the gap between marketing and sales. And we happen to speak your language. Our team requires little ramp-up time due to our deep background in financial services, alternative investments and commercial real estate. We know the ins and outs of marketing as well as compliance regulations. And we understand how to get financial advisors to engage with your firm. Our work makes your clients take notice.



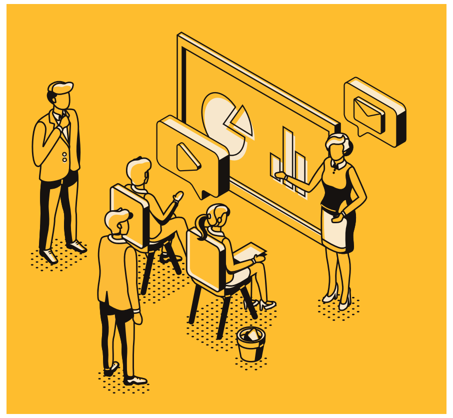
As advisors complete due diligence on sponsors and decide with which to trust client investments, it's important for sponsors to be prepared to provide advisors with key information about their firm and their offerings. Many aspects of the advisor due diligence process are top of mind, like the sponsor's track record, key differentiators and how sponsors underwrite a deal. Yet one area that can affect both advisors and their clients on a regular basis is often not ranked as a high priority by sponsors in the advisor due diligence process—marketing and communications.

Below, we'll discuss the key areas where sponsors should focus their marketing and communications efforts to help their firm and offerings stand out positively in the due diligence process.

Offering Materials

In the offering materials category are your fund brochure, fact sheet, PPM/prospectus and your website—even if your firm is working with private placements and can't feature in-depth fund information on the site. Your offering materials—especially your website—is often where advisors start to evaluate your firm. Here are the questions advisors will ask and what they mean:

- Is your website high-quality and clear? Advisors want to share a sponsor/offering with their clients that warrants the level of investment required. Is your site communicating your offering as a Nordstrom or a Kmart? If it's appearing like Kmart, your site is not doing its job.
- Are the materials current? If materials aren't current while you're marketing your offering, advisors will assume your materials won't be current after they invest their clients in an offering either. This can put them in a bind in providing timely updates to or answering questions from their clients if they invest.
- Is the "why" clear? With a growing number of alternative investment offerings, your "why" is important to both advisors and their clients. What demand drivers are behind what you're doing? What problem are you solving? Advisors want to know.
- Is your investment rationale well explained? Complex investment strategies are common in our industry, but advisors don't have the time to decipher what you're doing. Boil it down to a clear, concise statement.



As high-quality and as current as your marketing materials might be, it's important to supplement them by providing advisors with access to the people behind the offering. Again, think about an advisor asking a client to invest a significant amount of money with a sponsor and not knowing who is behind the offering. Provide access to your management team on webinars, earnings calls, at due diligence meetings and one-on-one meetings if your management team has the capacity.

- Are there client-approved materials for you to use? Advisors need client-approved materials to pass your story on to their clients.
- Has the PPM/prospectus been supplemented? While not technically marketing, an updated PPM/prospectus lets advisors know you keep information current and it allows your sales team to talk about material events happening with your offering. Some law firms prohibit sponsors from discussing events like property acquisitions unless they have been added to the prospectus or PPM via a supplement.

Portfolio Updates

For commercial real estate offerings, updating portfolio information regularly boosts advisor confidence that they will always have current information. It's also your chance to demonstrate you are proving out your investment thesis. Use a portfolio summary, ownership maps, property acquisition/dispositions flyers and press releases to make portfolio updates. Advisors will be looking to see how often they can expect updates, how quickly after a purchase or sale a sponsor communicates it, and if press releases are distributed timely.

Events & Access to Management

As high-quality and as current as your marketing materials might be, it's important to supplement them by providing advisors with access to the people behind the offering. Again, think about an advisor asking a client to invest a significant amount of money with a sponsor and not knowing who is behind the offering. Provide access to your management team on webinars, earnings calls, at due diligence meetings and one-on-one meetings if your management team has the capacity.

Thought Leadership

Increasingly, sponsors are providing advisors with thought leadership content on their asset class or investment rationale. While you live and breathe your investment strategy and offerings, advisors do not. They are not commercial real estate or alternative investment experts. Providing advisors with easily understandable and "snackable" thought leadership provides confidence that you want them to truly comprehend what you're doing—not just invest in it. Thought leadership also helps advisors build their information bank about your firm and offering to pass along your story and their confidence in your firm to their clients. Think about how often you're publishing your thought leadership content—consistency is key. Also consider where you're publishing your content. Can advisors find you in key industry publications through outlets like ADISA, Blue Vault and DI Wire?

Investor Communications

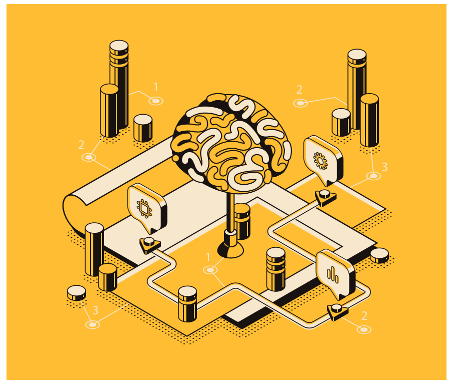
New sponsors to the alternative investments space frequently overlook the importance of the back-end communications that occur after an advisor invests a client in their offering. As a result, these areas often become a pain point for advisors because sponsors struggle to improve the communications on the fly based on advisor and client feedback. Plan your communications and evaluate them from the advisors' and clients' perspective. Be prepared to share examples of investor communications with advisors to build confidence.

- Statements – Share an example with advisors of how your statement or your offering will show up on a consolidated statement.
- Property-Level Reporting – Explain to advisors if your firm provides property level reporting and provide an example.
- Investor Portal – Does your firm have its own investor portal? Or do you use a third-party portal? Advisors want to understand their client's access to investment and other information once they're invested in your offering.
- Major Updates – How can advisors and their clients expect to get major updates from your firm? What's your communication protocol? Share this with advisors.
- Crisis Communications – While the goal is smooth sailing with your offerings, you never know when another "black swan" event will occur. When it does, how will you communicate with advisors and investors? When should they expect to hear from you? Share your plan.

Marketing & Communications Operations

Now that we've covered ***what*** you should communicate, it's also important to think about ***how*** you'll communicate. Advisors can be highly sensitive to how much sponsors reach out to them. Once they invest in your fund, let advisors know how you plan to communicate with them and the frequency. Advisors are also sensitive to sponsors communicating directly with their clients—especially if they aren't kept in the loop. Share your plan for investor communications with advisors and explain how you will keep them informed on those communications (e.g., sending communications to advisors in advance of investors). Finally, do you provide advisors with an online portal of materials on your offering, so they have on-demand access to key pieces and information? A self-serve way to access information helps build trust and confidence with advisors.

As the landscape of alternative investment offerings continues to grow, it's essential for sponsors to consider the advisor experience with their firm. High-quality marketing and communications can be the difference in why an advisor chooses and continues to work with a sponsor. A solid marketing and communications strategy can help sponsors elevate their firm, develop trust through transparency and create an enduring relationship with advisors and investors. ▲



Providing advisors with easily understandable and "snackable" thought leadership provides confidence that you want them to truly comprehend what you're doing—not just invest in it. Thought leadership also helps advisors build their information bank about your firm and offering to pass along your story and their confidence in your firm to their clients.

Limits on Non-Exchange Traded REIT Redemptions Are Necessary and Beneficial to Investors

By John Grady, *ABR Dynamic Funds*

With 30+ years of investment management experience, John serves as ABR Dynamic Funds' chief operating officer and general counsel. The firm is a registered investment adviser, managing several mutual funds and UCITS sub funds using proprietary volatility-driven strategies, as well as certain private funds. John serves as Vice President on ADISA's Board of Directors, as well as co-chair of ADISA's Legislative & Regulatory Committee.

In recent months, as the Federal Reserve's campaign against lingering inflation has led to higher cost of capital and a resulting decline in real estate valuations, the financial press has reported on efforts by large, non-exchange listed real estate investment trusts to limit the amount of shareholder redemptions that these REITs will process. Much of the coverage has suggested that such limits were "surprising" and "unwelcome," while some have asserted that these limits point to a weakness in the real estate sector.

Not unexpectedly, some regulators have begun to characterize these developments as indicative of poor product design and investor disappointment (if not worse). Some stories suggest, moreover, that these announced limits are akin to the "gates" on redemptions exercised by hedge funds that can shut down redemptions at their discretion and have done so at inopportune times for their investors.

This narrative is neither fair nor accurate. The non-exchange listed REITs in question continue to perform as designed, from everything we can see. There are investors looking to redeem significant numbers of shares of these REITs of late—that part of the narrative is undoubtedly true. And some large REITs have made it clear that their share redemption programs cannot accommodate all of the current and pending redemption requests in the present moment. We do not know, however, why these investors have decided to redeem now—they might be trying to take gains to match against losses in other parts of their portfolios, or they might be trying to redeem REIT shares in order to allocate to other investments in what has generally been a significantly tumultuous investment landscape, especially for such interest rate-sensitive investments as real estate. All we know is that they are doing so and that the non-exchange listed REITs in question are making it clear to the marketplace that their redemption programs have limits that must be maintained.

It is a significant leap to go from what we know to the idea that limits on shareholders' ability to redeem constitutes proof that their structure and redemption programs are not appropriately designed or are not functioning as intended. Redemption programs are just one way that investors in real estate that want liquidity can gain more of it. Shareholders can access liquidity through secondary market sales, an increasingly popular alternative and one that does not require the REIT to expend its cash to satisfy. Alternatively, investors desiring total liquidity for their real estate allocations can buy exchange listed REITs; of course, in doing so they get increased volatility and potentially lose the so-called "illiquidity premium." Or they can buy real estate mutual funds; those vehicles offer daily redemptions, but with a price per share that also incorporates the volatility of the market for exchange listed REITs.

Perhaps more importantly, it is important to keep in mind that these redemption programs were designed to create partial, not total, liquidity for shareholders. Long-standing US tax policy limits redemption programs offered by non-exchange listed REITs to 20% of their outstanding shares measured annually, which translates into a 5% per quarter limit. Exceeding that limit by itself could cause a non-exchange listed REIT to lose its favorable tax treatment under the Internal Revenue Code. These redemption plans give investors a means of accessing liquidity, but not without limits. These elements are carefully designed and fully described in their offering documents; liquidity limits get appropriate focus.

The portfolios amassed by non-exchange listed REITs are made up principally of illiquid real estate assets. It is these assets that produce the income or other benefit that the REIT is trying to bring to shareholders. It is simply not possible to have an investment vehicle that invests to a large degree in illiquid assets turn around and offer substantial liquidity to shareholders without either forcing sales of illiquid assets, taking on additional leverage (borrowing) or distributing illiquid assets to shareholders. Such liquidity is not simply part of the non-traded REIT approach and may not be in the interests of the REIT's shareholders. Having a non-exchange listed REIT offer higher or unlimited redemption levels would necessarily require them to keep cash or liquid assets to satisfy their redemption programs. Worse, having them sell illiquid real estate assets to meet these redemptions would be like a farmer cutting down a productive orchard for a quick stash of firewood. Even the 20% per annum programs place a burden on non-exchange listed REITs to maintain the cash needed to fund redemptions. One cannot hold cash or sell land for cash while still earning the same level of income for investors.

Non-exchange traded REITs require discipline and a long-term investment approach in order to realize optimal returns. They are marketed as such, with their largely illiquid nature clearly explained in their offering documents. The fact that today's non-listed REITs offer some liquidity to shareholders shows that sponsors and managers can respond to market demands and to concerns voiced by regulators and others about a lack of investor liquidity. Limits on redemptions are both necessary (from a regulatory and investment management perspective) and beneficial to the ultimate results that real estate investment can provide.

In the end, a portfolio must be matched to the liquidity opportunities offered to shareholders —if a non-exchange listed REIT has an illiquid portfolio, it cannot offer the same liquidity to investors as a fund that owns liquid—and more volatile—assets. To be sure, issuers and distributors of non-exchange listed REITs should carefully describe the limited liquidity features of the fund and ensure that investors and their advisers understand and anticipate the liquidity stipulations involved with non-exchange listed REITs. And regulators should continue to be vigilant in their efforts to make certain that liquidity limits are clearly disclosed and explained to investors BEFORE they become shareholders. But let's not allow a natural, understandable, and purposeful product feature—limited issuer liquidity—to be equated with poor product design. After all, if it were not for the liquidity offered by shareholder redemption programs, no matter the amount, investors would have fewer opportunities for liquidity. As long as the liquidity features are properly disclosed and understood, the result is good for investors. ▲

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Six Things You Need to Know About Qualified Opportunity Zone Funds in 2023

By Griffin Capital Company

Griffin Capital Company is a vertically-integrated real estate investment company focused on bespoke investment strategies underpinned by durable secular growth themes as a catalyst for creating strong, risk-adjusted performance.

1. Deferral of Tax Liability on Any Capital Gain Invested in a Qualified Opportunity Zone Fund ("QOF") Until December 31, 2026

How often do you get an interest free loan to invest in something that can grow tax free? The deferral of the tax liability allows an investor the ability to put capital to work that has the opportunity to grow tax free. In addition, it provides time to engage in proactive tax planning for a future gain event that will occur at a pre-determined time (December 31, 2026). This provides the opportunity to potentially minimize the capital gain tax liability when it comes due. How often do you get to prepare for a number of years in advance of a gain event you know will occur?

2. Elimination of Capital Gain on the Appreciation of the Investment of QOF if Held for at Least 10 Years

There are very few investors who do not like the idea of creating pools of capital that will grow tax-free. If you like the underlying investment and you have a capital gain, a QOF may be a very tax efficient way in which to take that exposure given the elimination of capital gains on the appreciation of the investment.

3. Spreading Tax Liability Over Multiple Tax Periods

Investing in a QOF is not an all or none proposition. An investor may invest all or part of a capital gain in a QOF. Investors with large capital gains may want to spread the tax liability over multiple periods by realizing some of the gain in the current period and investing some of the gain in a QOF to push that portion to tax period 2026, payable in 2027.

4. Retroactive Tax Planning Benefits

An investor realizing a capital gain through a pass-through entity like a partnership of S-Corp has three eligible 180-day windows in which to place that capital gain into QOF. The most generous of those windows allows for that investor to invest in a QOF up until September 11 of the following year in which the gain was realized (assuming their pass-through has a tax year ended December 31). This extended look-back provides tremendous opportunities in 2023 for investors who realized gains in 2022. Investors that realized a capital gain outside of a pass-through entity generally have 180 days from the date of gain realization to invest in a QOF. All QOF investments can be made across calendar years as long as they are made within their eligible 180-day windows.

5. Keeping Your Valuable Losses

You do not need to net your losses when determining eligible gain to invest in a QOF. It might be more valuable to carry those losses forward when you do not have a tax strategy like a QOF to utilize or if capital gain rates increase in the future. You may also be able to use those losses in 2026 to offset the tax liability with respect to the gain that was invested in a QOF, to the extent those losses were not used in prior tax-years.

6. Investing Across Calendar Years

An investment in a QOZ must be made within a compliant timeline but that timeline can span across calendar years. A QOZ investment made in 2023 can apply to capital gains realized in 2022 as long as it is made within a compliant timeline. ▲

ADISA Announces 2023 President-Elect and Officers

At its first Board meeting of the year, the new ADISA (the Alternative & Direct Investment Securities Association) Board, elected by the membership in late 2022, selected its 2023 officers. Michael Underhill of Capital Innovations begins his term as the 2023 ADISA president, and Jade Miller of Bourne Financial Group was elected as the 2023 president-elect and will serve as president in 2024.

The other ADISA officers selected were: John Grady of ABR Dynamic Funds as vice president; Catherine Bowman of The Bowman Law Firm as secretary; and Mark Kosanke of Concorde Investment Services as treasurer.

The other ADISA 2023 Board of Directors are: Angela Barbera, NexPoint Securities; Sherri Cooke, iCapital; Mat Dellorso, WealthForge; Matthew Iak, U.S. Energy Development Corporation; Karlton Kleis, Arete Wealth Management; Sylvia Kwan, ElleVest; Stephen Lovell, Lovell Wealth Management; Greg Mausz, Skyway Capital Markets; Ann Moore, International Assets Advisory; David Pittman, Cottonwood Residential; Jeff Shafer, CommonGood Capital; Amanda Teeple, CoastalOne; Brad Updike, Mick | Law; and David Wilson, Equifinancial. Darryl Steinhause of DLA Piper also serves as a non-voting, volunteer legal counsel and Thomas Voekler of KVCF provides volunteer hospitality legal counsel.

ADISA Hosted Second State Regulator Educational Program

On Monday, March 27, ADISA board members presented an educational program regarding the alternative investment industry to delegations from the Southwest in Austin, Texas. Representing ADISA were John Grady, ABR Dynamic Funds; Catherine Bowman, The Bowman Law Firm; Greg Mausz, Skyway Capital Markets; and Jennifer Fitzgerald, and they presented to regulators from New Mexico, Oklahoma, Texas and Utah. In addition to a comprehensive briefing on alts, there was ample time for discussion and questions from regulators at which time ADISA representatives could effectively explain the structure and purpose of various investment products.

It was another highly successful event— more are being planned for other regions soon. ▲

MARRIOTT MARQUIS **SAN DIEGO** MARINA — **APRIL 24-26**

ADISA 2023 Spring Conference

ADISA 2023 Spring Conference

ADISA's Spring Conference is quickly approaching—April 24-26, at the Marriott Marquis San Diego Marina. Make your plans to attend the leading conference for alternative investments, which will offer unprecedented educational and networking opportunities.

The conference will feature sessions on:

- New Investment Products
- Sponsor Deal Structures
- Social Media & the Internet
- Alts Technology Platforms
- Qualified Opportunity Zones
- Among others

As well as plenary sessions such as:

- Alts Industry Sector Reports
- A Legislative & Regulatory Update with FINRA and selected state and federal regulators
- A leading expert on energy and oil & gas
- And a sales & entrepreneurial duo

There is still time to register!
Broker-Dealers, RIAs and Family Offices receive complimentary registration and two hotel room nights—while rooms still last. IARs/Registered Representatives receive a discounted registration rate of $120, with one hotel room night—while rooms still last.

Sponsor Registration Rates
Member: $980 (with event exhibit/sponsorship); $1,560 (without event exhibit/sponsorship)

Non-member: $2,996

Affiliate Registration Rates
Member: $960 (with event exhibit/sponsorship); $1,580 (without event exhibit/sponsorship)

Non-member: $2,998 ▲

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