Mick Law, P.C. - Alts. News Bulletin
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For this bulletin, our focus will be placed upon income taxation developments proposed by President Biden's administration, as well as information pertaining to capital raising trends observed in the Sect. 1031 product sector. We will also discuss recent market developments relating to oil/gas sponsors and products, and recent changes to the filing requirements under FINRA Rule 5123.

Income Tax Developments

As we stated in prior newsletters, President Biden's tax plan proposes to substantially limit the capital gains tax deferral benefits associated with real estate like kind exchanges conducted under the Internal Revenue Code of 1986, as amended ("IRC") Section 1031. Closing that tax benefit, which has existed within the IRC since 1921, is part of President Biden's 2022 budget proposal. President Biden's proposed tax changes are discussed within the Treasury Department's **Green Book** for Fiscal Year 2022.

Under the proposal as it relates to Section 1031 exchanges, future deferrals of capital transaction gains would be limited to $500,000 for each taxpayer ($1 million for married taxpayers filing a joint return) each year for **real property** exchanges that are like-kind. Any gains from like-kind exchanges exceeding these limits would be recognized by the taxpayer in the year of the exchange. In respect to its efforts to target like kind exchanges, the Biden administration's theory is that the limits on deferred gain, plus increased capital gains rates (described below), will increase government revenue by $19.6 billion over 10 years to help fund the administration's spending objectives. On a practical note, this estimate, if accurate, will fund **only 1.6%** of President Biden's $1.2 trillion infrastructure improvement plan (Source: Kohrman Jackson & Krantz LLP 2021)

Certain other tax proposals set forth in the Green Book that could impact your investor clients with holdings in real estate properties and securities are summarized below:

- The proposal seeks to increase the maximum capital gains and qualified dividends rate from 20% to 39.6% for taxpayers with $500,000 of adjusted gross income ("**AGI**") or more (or $1 million AGI for married couples filing jointly). **The rate increase is to be retroactive, and as proposed, would apply to capital gains realized after April 28, 2021**.

- Under the proposal, the step-up in basis at death for capital assets would be eliminated, and transfers of appreciated property by gift or on death will also be treated as realization events. This means that property donors and deceased owners would recognize capital gain at the time of the realization event based on the asset's fair market value at the time of transfer.

- The proposal would require the recognition of unrealized appreciation by partnerships, trusts, and other non-corporate entities that are the owners of property if that property has not been subject to a recognition event in the prior 90 years. According to the Green Book, the look-back period begins Jan. 1, 1940 (thus, this aspect of President Biden's proposal would not become operational until Dec. 31, 2030).

- The proposal would also treat contributions to, or distributions from, partnerships, trusts and other non-corporate entities (other than a grantor trust that is deemed to be wholly owned and revocable by the donor) as recognition events. This would substantially affect the fundamentals of partnership taxation in a negative way as contributions to and distributions by partnerships have been tax free for many years.

The DST sector of real estate, which utilizes Section 1031 exchanges as a component of the product structure, has been an active retail program segment over the past several years and has experienced over $3.2 billion in sales in 2019 and 2020. This momentum carried over into the first six months of 2021, with a capital raise volume of $2.55 billion realized among 37 product sponsors. According to industry sources we have spoken with, the average DST subscription is approximately $300,000, with most tickets falling within a range of $300,000 to $500,000. We note that the impact of the President's proposal, while ***not*** fatal to the DST program sector, would present a headwind for sponsors who have been successful in procuring larger subscriptions from sophisticated investors.

On a related note, our leading trade associations, which include the Alternative & Direct Investment Securities Association ("**ADISA**") and the Institute for Portfolio Alternatives ("**IPA**") have been hard at work in advocating our interests in respect to President Biden's "radically-social" tax proposal. Information regarding ADISA's advocacy and outreach efforts on Section 1031 can be viewed at https://www.adisa.org/news-advocacy/1031-resources-actions, which includes press releases and articles relating to ADISA's policy position and recent meetings with Congressional members. The IPA also maintains a Section 1031 advocacy portal at https://www.ipa.com/1031s/. The IPA's portal contains recent news releases, advocacy letters, and white papers supporting the future viability of Section 1031 for our industry. In summary, we applaud the effort of our industry's associations in taking proactive measures to help support our interests in keeping IRC Section 1031 a viable tax planning alternative for millions of accredited investors. We encourage you to reach out to your local Congressmen regarding the benefits of IRC Section 1031 and the need to prevent the passage of President Biden's proposal.

Section 1031 Product Activities

Despite the headwinds presented by President Biden's tax proposal, securitized Section 1031 product sales are positioned for significant growth going into the second half of this year. Through June 2021, the Section 1031 product sector reported $2.55 billion in raised capital, representing a 53% increase as to the capital raised as of June 30, 2020. This result was achieved through the syndications of 37 sponsors that offered 141 programs. A summary of certain Section 1031 product statistics relating to the $2.55 billion in product sales is provided below:

Top Five Sponsors
Inland Private Capital (19%)
Capital Square (15%)
ExchangeRight (8%)
Passco Companies (7%)
Cantor Fitzgerald (6%)

Top Sectors
Multifamily (50%)
Retail (16.3%)
Industrial (9%)
Self-Storage (7%)
Manufactured Housing (6%)

Top States – Properties Located
Texas (26)
Florida (20)
Georgia (17)
Illinois (15)

North Carolina (11)

On a related note, the Section 1031 offerings closed in 2021 spent an average of 131 days in the market, with a median market time of 79 days. **Despite these averages, it has come to our attention that many DST offerings are closing within a matter of days and with many reps/advisors selling subscriptions prior to the completion of program level due diligence (with assets in the multifamily sector in particular tending to sell very quickly)**. We caution you to be vigilant in your due diligence of these products going into the remainder of this year.

Oil & Gas Market Developments

On a favorable note, oil and natural gas prices have rebounded from a challenging year in 2020. As of July 27, 2021, the WTI spot price for oil was $71.91 bbl, with the NYMEX futures price for natural gas deliveries in August 2021 being $3.96 per mcf.

In the natural gas futures market, the monthly prices published by the CME Group from today through December 2022 range from $3.10 per mcf to $4.10 per mcf, which could enable many natural gas producers to lock in favorable prices going into the fall of 2021 and for 2022. Within its energy report published on July 16, 2021, Raymond James also forecasted natural gas prices to average $3.50 per mcf in 2021 and $4.00 per mcf next year. While this news is comforting, please note that certain markets are experiencing pricing differentials that range from $0.20 per mcf (WAHA hub, Permian) to $0.80 per mcf (DTI South, W. Pa). **As such, we recommend that you refer to our asset underwriting for information regarding local pricing and how the same potentially affects future investor returns.**

As published by the CME Group, monthly oil futures through December 2022 range from $63 bbl to $70 bbl. While oil spot prices dipped into the mid $60s bbl a few weeks back, prices have rebounded on news concerning OPEC's production plans going into the later months of this year. Based upon economic information published by the Energy Information Administration ("EIA"), the world's oil demand is recovering significantly from the COVID levels observed last year:

> "*We estimate that global consumption of petroleum and liquid fuels averaged 92.3 million barrels per day (b/d) for all of 2020, down by 8.6 million b/d from 2019. We expect that global liquid fuels consumption will grow by 5.3 million b/d in 2021. In our forecast, global consumption of*

liquid fuels rises by an additional 3.7 million b/d in 2022 to 101.4 million b/d, which would surpass 2019 levels."

EIA Short-Term Outlook (July 7, 2021)

Without surprise, the higher commodities prices have also translated into varying levels of rig count growth across the U.S. Based upon rig activity data provided by Baker Hughes, the rig count trends within several major onshore U.S. basins are provided in the following table (with all eleven major basins, including the Permian Basin, Eagle Ford Shale, and Marcellus Shale reporting rig count growth over the past year):

Basin	**7/16/2021 Rig Count**	**Rig Count A Yr. Ago**	**1 Yr. Change**
Arkoma/Woodford Region	18	7	157%
DJ-Niobrara	11	4	275%
Eagle Ford Shale	32	11	290%
Granite Wash	1	0	100%
Haynesville Shale	49	32	53%
Marcellus Shale	28	27	4%
Permian Basin	238	124	91%
Utica Shale	10	6	67%
Williston Basin/Bakken	18	10	80%

Source: Baker Hughes Rig Count July 16, 2021

On a related note, our firm has completed due diligence on several oil and gas programs, and with our due diligence continuing in respect to some other sponsors. A table that summarizes our completed and open due diligence engagements in the oil/gas sector is provided below.

Sponsor	**Strategy**	**Opinion Status**
Mewbourne Energy Partners 2021-A	Horizontal Drilling – Permian and Anadarko Basins (Oil/Wet Gas)	Program level opinion is available
MDS 2021 Marcellus Shale Development	Horizontal Drilling – Marcellus Shale Play (Dry Gas)	Program level opinion is available
APX New Harmony F	Vertical Drilling – Illinois Basin (Oil)	Program level opinion is available
Waveland Resource Partners VI	Opportunity Fund –	Program level opinion is available

	Strategic Acquisitions of Mineral Rights in Bakken Play and Permian Basin	
John Henry Oil – Trenton Black River IV	Vertical Drilling – N. Tennessee (Oil)	Sponsor/program level due diligence is in process
USEDC 2021 Drilling Fund	Horizontal Drilling – Permian Basin (Oil/Gas)	Program level due diligence in process
S.T.L. Resources Drilling Fund C	Horizontal Drilling – Marcellus Shale Play (Dry Gas)	Program level due diligence in process
Resource Royalty XV	Mineral rights – C. Oklahoma with direct title structure (1031 eligible)	Program level due diligence in process
Montego Midland Mesa Minerals	Mineral rights – Permian Basin with direct title structure (1031 eligible)	Program level opinion is available

FINRA Expands Filing Requirements for Private Placements Under Rule 5123

Please be advised that FINRA has expanded its filing requirements in regard to private placements to include retail communications. As such, all FINRA member firms that participate in private placements will be required to file private placement related sales literature, brochures, executive summaries, and power points with FINRA.

Before this rule expansion, Rule 5123 previously required members to file private placement offering documents within 15 calendar days of the date of first sale. The expansion of Rule 5123 to retail communications was foreshadowed by the Securities and Exchange Commission ("**SEC**") pursuant to SEC Release 34-90302 (the "**SEC Release**"), which was published on November 2, 2020. In the SEC Release, the SEC explained the need for an extension of Rule 5123 based upon a significant trend of observed Rule 2210 non-compliance among retail communications used to promote various private placement offerings.

The SEC Release reported that between January 1, 2017 and March 31, 2020, FINRA's Advertising Regulation Department reviewed 1,726 private placement related retail communications from new members and from other members that voluntarily submitted such communications for a Rule 2210 compliance review. Of the reviewed materials, 41% of such retail communications required revisions and 4% were found to be so non-compliant that FINRA issued "DO NOT USE" notifications. In comparison, the SEC Release reported that only 8% of all other types of retail communications required revisions, and with DO NOT USE notifications being issued to only 0.40% of such other communications. The most common rule infractions mentioned within the SEC Release that pertain to private placement related communications included the following:

- The use of prohibited projections of performance and unreasonable MOIC/IRR forecasts (with return targets falling within this category of non-compliance);
- The use of misleading statements (e.g., statements overemphasizing "safety of principal" and the use of unfair comparisons relating to the sponsor's business strategies and/or product features);
- The failure to prominently disclose the material risks of the securities sold within the private placement (e.g., as to the lack of liquidity and/or the risk of investment principal loss).

In view of the rule change, FINRA members will need to be vigilant in their reviews of private placement retail communications going forward. The new rule will go into effect October 31, 2021.

Upcoming Industry Events

ADISA Annual Fall Conference & Trade Show (2021)
The Wynn - Las Vegas
October 4-6, 2021
https://www.adisa.org/events

IPA Vision 2021 and Due Diligence Symposium
Renaissance Chicago - Downtown Hotel
September 27-29, 2021
Chicago, Illinois
https://www.ipa.com/ipavision2021/

Mick Law P.C. Real Estate Symposium
Scottsdale Marriott at McDowell Mountains
October 24-26, 2021

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