Mick Law - Alts. News Bulletin
June 9, 2023

For this edition, we'll provide you with an update on IRC Sect. 1031 product sales activity, as well as an overview of capital raising developments pertaining to oil/gas programs. We'll also provide you with an overview of the EcoVest settlement, as well as an overview of differing tax features within fee simple programs vs. conservation oriented real estate programs. We end with some announcements on upcoming events.

DST Market Overview

Despite the economic headwinds occasioned by inflation and rising interest, forty-seven (47) DST sponsors managed to raise $1.482 billion in equity across 97 programs in Q1 2023. For Q1, 2023, the top DST sponsor in terms of capital raised was Ares Real Estate Exchange ($286 million, 19% of the DST market), followed by Inland Private Capital ($147 million, 10%), Capital Square Realty Advisors ($142 million, 10%), JLL Exchange ($118 million, 8%), ExchangeRight Real Estate ($117 million, 8%), Net Lease Capital Advisors ($68 million, 5%), and Passco Companies ($62 million, 4%). These seven companies accounted for 64% of the DST capital raised last quarter. In terms of sector coverage, multi-family assets continue to account for the highest percentage of the DST equity (37%), which was followed by Industrial (23%), Office (17%), and Self-Storage (6%).

A breakout of equity sought, loan-to-values, days on market, and year-one cash on cash returns among the various real estate sectors in terms of open programs is provided in the following table:

Sector	Available Equity	Median Loan to Value	Days on Market	Cash on Cash
Oil & Gas	$100 million* Three open deals	No Leverage	NA	NA
Hospitality	$78 million Three open deals	49%	67	5.57%
Industrial	$761 million 14 open deals	46%	160	3.85%
Multi-Family	$1.243 billion 41 open deals	41%	184	3.90%
Multi-Manufactured	$28 million One open deal	20%	165	4.00%
Multi-Student Housing	$123 million Three open deals	44%	214	3.86%
Office	$576 million Six open deals	35%	122	4.84%
Office/Medical	$25 million Two open deals	0%	120	4.00%
Retail	$186 million 18 open deals	43%	168	4.03%

Self-Storage	$195 million 8 open deals	37%	88	4.41%
Senior Housing	$84 million Five open deals	33%	79	5.44%
Other	$7 million Two open deals	0%	27	2.78%

*Oil & Gas 1031s are structured as fractional interest programs

Of the 100-plus 1031 deals that were open at the end of Q1 2023, the average days on the market was 151 and the average year-one cash on cash return was 4.15%. Also, of the open 1031 products on the market, about a third are reporting that they are all cash with no leverage used.

Oil & Gas Fundraising – 2022 & 2023

Despite the headwinds from the left side of our government seeking to impose the *Green Agenda* to displace fossil fuels with more carbon-friendly sources, 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.

In 2022, we covered fourteen (14) 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.

As of June 5, WTI price for oil was $72.69 per barrel (bbl), with the NTMEX spot price for natural gas being $2.29 per mcf. While natural gas pricing will probably remain challenged for much of this year, there is sentiment from the futures market that natural gas prices will begin to rebound at or above $3.00 per mcf in Q4 2023 and throughout all of 2024. Against this pricing backdrop, we note that seven of the 14 sponsors we cover have open deals, which are collectively seeking about $1.35 billion from the retail/RIA channels:

Company	Max. Offering	Strategy
U.S. Energy	$300 million $150 million $100 million	Drilling QOF/QOZ 1031/Royalties
Waveland Res. Partners 6	$100 million	Non-Op Working Interests
Mewbourne Oil Co.	$175 million	Drilling
MDS Energy Dev.	$400 million	Drilling

Resource Royalty 19	$9.32 million	1031/Royalties
Montego Energy Partners	$12.39 million	1031/Royalties
WhiteHawk Income Corp.	$100 million	Royalties/Minerals

In addition to the seven sponsors that have open deals, several additional sponsors are expected to begin their due diligence in relation to their 2023 capital efforts. The companies that we expect to review over the next 60-90 days include the following:

Company	Strategy	Engagement Status
R.G. Partners	Drilling/Production	Engagement Signed – Opinion Expected June 2023
John Henry Oil	Drilling	Engagement signed
Texakoma Resources	Drilling Non-Op WI	Engagement Sent
Texas Standard Energy	Drilling	Engagement Signed – Opinion Expected June 2023
STL Resources	Drilling	Engagement Signed – Opinion Expected June 2023
Waveland Res. Partners 7	Non-Op WI	Engagement Letter Sent
APX Energy LLC	Drilling	Engagement Letter Sent

EcoVest Settlement – Sponsor Perspective

EcoVest Capital, LLC (“**EcoVest**”), a sponsor of non-traded real estate investment programs accused of participating in a tax scheme that generated $3 billion in charitable deductions for donated conservation land, agreed to settle its case with the U.S. government. The settlement came in April after four years of litigation, 60 depositions taken, 17 expert witness reports, and hundreds of appraisals exchanged.[1] Despite the protracted nature of the litigation, the government accepted EcoVest’s settlement offer with the following favorable terms:

- EcoVest and its principals expressly disclaimed any wrongdoing or liability;
- EcoVest and its principals are released from the Government’s claims that EcoVest pay over $130 million of disgorgement;
- EcoVest, its principals, and certain of its employees and consultants are released from additional potential claims not asserted in the case;

[1] See explanation letter written by attorney Sean Atkins, Covington & Burlington LLP (Apr. 27, 2023).

- EcoVest may remain the manager of the investment partnerships it had sponsored and continue to defend the charitable conservation easement deductions they claimed;
- EcoVest's principals are permitted to continue to place conservation easements on properties they own individually (on their own or through a partnership);
- In exchange, EcoVest agreed to make a settlement payment of $3 million, which is an amount less than it likely would have cost to try the case, and it voluntarily agreed to a "consent injunction" whereby it will no longer organize or promote syndicated conservation easement transactions (which Congress largely prohibited by law at the end of 2022).

To summarize, the settlement agreement allowed EcoVest and its principals to remain in business, maintain the status quo (in which they had already repositioned their business to non-easement investments), pay less than it would have cost to try the case, and be relieved from hundreds of millions of dollars of claims by the government, all while disclaiming any wrongdoing or liability. In our view, this resolved the case more favorably than trying the case and securing a victory from the court in the form of a decision.

What this Means for CE Structured Programs. Despite the favorable terms of EcoVest's settlement (i.e., as the settlement was 0.20% of the alleged program tax deductions), **we remind you** that the program syndication environment for conservation-oriented programs took an unfavorable turn earlier this year with the passage of the Omnibus Spending Bill (Dec. 2022). As a result of the Bill's passage, IRC §170(h) now limits an investor's charitable deductions pursuant to a "syndicated" conservation easement transaction to an amount that is 2.50 times the investor's relevant basis within the real estate partnership. The bill incorporates a new term "***relevant basis***," which is defined within the bill as "*the portion of such partner's modified basis in the partnership which is allocable…to the portion of the real property with respect to which the contribution…is made*." This means that regardless of the highest and best use of a property and any built-in gain based on a bargain sale, the Tax Court will now have to determine the value only as to whether the rights given up exceed 2.5 times the partners' total relevant basis. The Omnibus Spending Bill provides for one exception to this rule, which applied to real estate held by a partnership for three years. The three-year holding period requirement requires that the partnership itself has held the real property for at least three years and each partner's ownership interest in the partnership remain unchanged for at least three years. The three-year holding period applies to all partnerships, including tiered partnerships.

To structure certain programs around the amended version of IRC §170(h), **we have come to learn that a few sponsors are preparing to launch programs designed to provide similar income tax incentives to accredited investors through fee simple donations of real estate to qualified organizations**. Acknowledging this trend, **we warn you** of the differing valuation rules that arguably apply to outright fee simple donations of real estate vs. transactions involving conservation easements (i.e., as a fee simple donation is predicated upon the arms-length fair market value of a donated asset per Treas. Reg. §1.170A-1 as opposed to a derivative of fair value method predicated upon the assets highest and best use per Treas. Reg. §1.170A-14(e)). Other key differences between conservation easement and fee simple donations are summarized in the chart below:

	Conservation Easement	**Fee Simple**
Tax authority	IRC §170(h)	IRC §170(a)
Interest conveyed	partial yet perpetual interest in real estate	entire interest in real estate
Transfer instrument	easement deed	warranty deed
Conservation purpose and perpetuity	must satisfy requirements in Treas. Reg. §1.170-14	not relevant
Donee	qualified organization, which may be a land trust or government body	an organization listed in IRC §170(b)(1), including but not limited to public charities
Property holding period	three years for syndicated transactions; one year for family partnerships	one year
Deduction limitation	cannot exceed 2.5 time the investors' basis in the partnership (exceptions for property held for at least three years and family partnerships)	None
AGI limit	50% of AGI[2]	30% of AGI[3]
Carry forward	15 years	5 years
Appraisal	qualified appraisal and appraiser required[4]	Same
Valuation approach(es)	"before and after" taking into account a property's HBU	"willing buyer and willing seller" standard, which may consider comparable sales, capitalization of income, or replacement cost
Restrictions on done	yes, conservation value must be protected into perpetuity through an Easement Deed	none, although the donee must notify the IRS if it disposes of the real estate within 3 years of the gift.
Audit risks	listed transaction disclosure required	listed transaction disclosure likely required

Please note that we intend to address such valuation differences within our program level due diligence opinions issued over the next couple of months.

Problematic Trends – Leveraged Deduction Deals

On a related note, and in relation to tax-advantaged programs, we have become aware that there are multiple new sponsors syndicating various programs around a charitable deduction concept. In the programs we have reviewed (and in multiple cases, we rejected), the program concept involved acquisitions by the programs of tangible property. In each case, the property consisted of either a bulk quantity of a natural resource with commercial use (e.g., magnesium, volcanic ash), or a bulk quantity of a medical supply used by hospitals to treat patients. In each of the cases, the program

[2] IRC §170(b)(1)(E).
[3] IRC §170(b)(1)(B).
[4] Treas. Reg. §1.170-17

concept involved questionable claims by the sponsors concerning the valuations of these raw materials and the abilities of the program partners to realize a sizable tax deduction based upon the spread between the price the programs paid for the materials and the asserted valuations. In each case, the raw materials were also erroneously classified by the sponsors as capital assets to justify a fair market value-based income tax deduction.

Ironically, these tax advantaged charitable deduction programs are being launched at a time in which the IRS has closed the loop on the use of conservation easements from a syndicated tax program structuring perspective. **Accordingly, we urge our clients to be vigilant in their due diligence of these tax-oriented programs, as the IRS will no doubt come to challenge these programs on multiple grounds in the future**.

1202 QSBS Webinar Announcement

On a final note, please join us June 13, 2023 (1 pm CST) for a webinar entitled *QSBS 1202: A Powerful Tax Benefit You've Probably Never Heard Of*. In this webinar, we will be examining IRC 1202, which provides a 100% capital gains exclusion to holders of qualified small business stock in early-stage technology and manufacturing companies. The webinar should be of interest to tax minded advisors seeking tax advantaged investment opportunities within the private equity sector. Registration for the webinar can be made at https://thediwire.com/.

AI Industry Announcements

ADISA's 2023 Alts Research & Due Diligence Forum
July 25-26
The Grand America Hotel
Salt Lake City, Utah

2023 Mick Law Real Estate Symposium
October 22-24, 2023
The Westin
Tempe, Arizona