# MICK QUARTERLY

*Alts. News Bulletin*

## Today's News

In this Edition, we provide an overview of developments affecting commercial real estate hospitality assets, as well as developments affecting oil/gas product sales. In addition to our discussions regarding the real estate hospitality and oil/gas sectors, we'll provide a summary of sales developments relating to offerings of Delaware Statutory Trust ("**DST**") products. We'll conclude with announcements of industry events.

## Quick Note: Introducing Publics in Private

During our last MICK 30 call, we interviewed Matthew Malone, CFA and Director of Investment Research at OPTO Investments. Matt has created a newsletter platform on LinkedIn called "*Introducing Publics in Private*."

IN THIS ISSUE

The articles illustrate certain opaque, hidden, and/or misunderstood data points and market trends historically reported within the SEC filings of public non-traded products (e.g., REITs and BDCs). The newsletter also educates readers on common types of glossed over facts, information and untold stories contained within the prospectuses and public filings to which program sponsors do not want to draw close attention.

Within the February 28 newsletter, Matt discussed the idea regarding the "illusion" of a "illiquidity premium" within private markets, as well as the types of information contained within the SEC filings that can be looked at to determine if a product manager has reasonably positioned its program in a way that is designed to outperform public product benchmarks. In illustrating his point, Matt referred to the prior performance of certain interval fund asset sectors (real estate, infrastructure, real assets, and private equity) and compared them to indexes based on public assets. His observations were as follows:

- Manager selection really does matter, as there was a wide range of performance outcomes across three of the four sectors; and
- On average, the four sectors, as a group underperformed the selected liquid index (although in two of the categories, at least one manager significantly outperformed, which showed the potential of a well-designed interval fund program).

In addition to providing helpful due diligence guidance, the newsletters are concise and are designed to be read/digested within a 2–5-minute reading time. We encourage all our clients to check out this informative newsletter in the future.

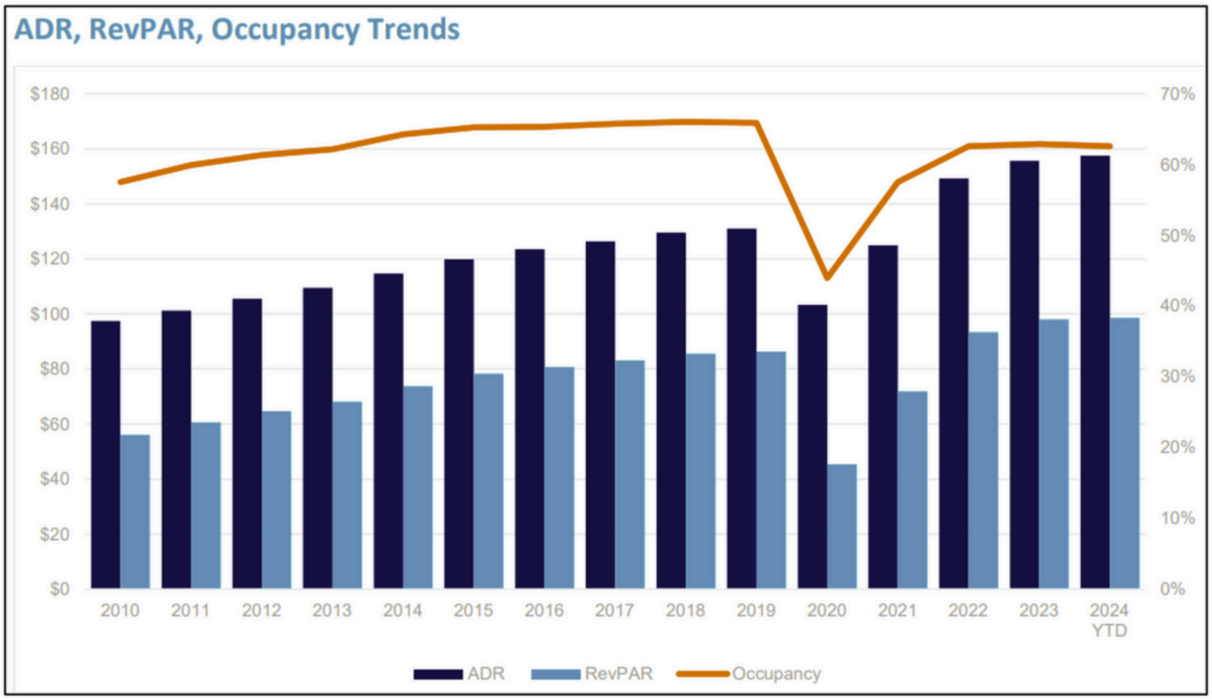
# U.S. Hospitality Sector

In this article, Kevin Vonnahme, attorney and shareholder, discusses current developments affecting assets within the U.S. Hospitality sector.

*U.S. Lodging Market.* According to the Cushman and Wakefield Mid-Year 2024 U.S. Lodging Industry Overview published in September 2024 (the "**CW Report**"), while supply growth has been constrained by the cost of debt and construction, it has still outpaced demand, resulting in a decline in occupancy. In terms of demand, the first half of 2024 compares favorably to 2023, with 636.6 million room nights sold, up from 635.8 million sold during the first half of 2023. Total supply is up, however, to 5.62 million rooms, which was up 0.5% over the year-end 2023 supply of 5.6 million rooms.

As a result, occupancy decreased slightly to 62.6% (down from 63% for 2023). Occupancy is still below the pre-pandemic (2018) level of 66.0%.

Revenue per Available Room (“**RevPAR**”) in the trailing twelve-month (“**TTM**”) period ending June 2024 reached a historical peak of $98.62, which was up over the year-end 2023 level of $96.18, driven by gains in Average Daily Rate (“**ADR**”). ADR increased to $157.50, which was up from $155.91 as of year-end 2023. A summary of U.S. hotel occupancy ADR and RevPAR can be found below.




Despite high interest rates and construction costs and waning market performance, hotel development pipelines continue to increase. According to Smith Travel Research (“**STR**”), as of the second quarter 2024, 157,713 rooms were under construction, equating to 20.8% of the total pipeline. This number is 5.5% higher than the number of rooms under construction in 2023. Coming through the pipeline are 266,619 rooms in final planning (up 9.8%), and 333,827 rooms are in planning (up 38.7%). The rooms under construction represent a 2.8% increase relative to the number of existing guestrooms at the end of the second quarter of 2024. If all proposed hotels were to open, the total projected 758,159 rooms would represent a 13.4% increase in supply. Notwithstanding, higher interest rates and challenges in obtaining construction financing are likely to curb delivery over the next few years.

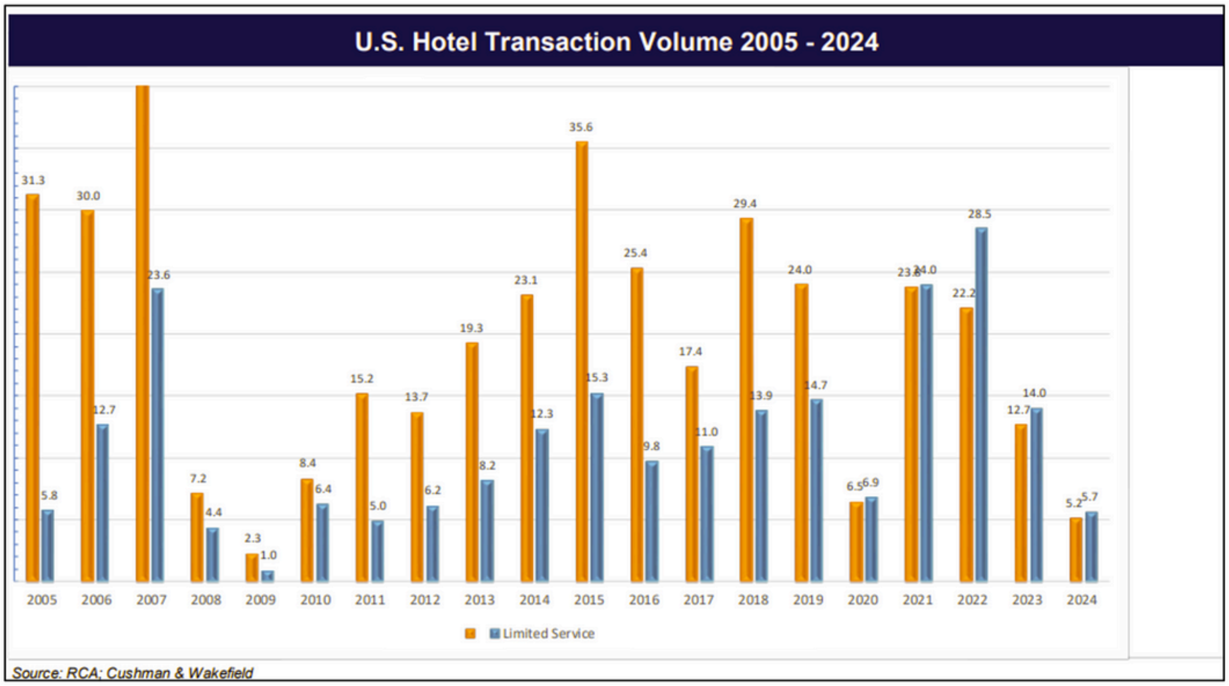
Since the pandemic, mid-week business has been one of the weakest links to a full recovery, particularly in urban areas. From 2020-2022, the ephemeral nature of reduced business travel was readily attributed to the sudden and global shift to work-from-home and the use of virtual meeting platforms. Now, the workplace has been established as a largely hybrid location, and leisure travel is the dominant driver of hotel use, although this segment continues to soften. Hotels continue to adapt to shifts in usage through design and pricing, but the translation of revenue strategies to bottom line benefits has been eroding as operating costs continue to increase and higher interest rates temper investment. Nevertheless, industry participants anticipate modest but continued improvement over the next few years.

*Investment Market.* According to the CW Report, on a national basis, hotel transaction volume through mid-year 2024 continued to be sluggish. Overall volume was down approximately 15% from $12.8 billion to $10.9 billion. Through the second quarter of 2024, the number of hotels sold declined 21%, resulting in an increase of the per room amount of 7.3%.

Hotel sales for both full-service and limited-service transactions are transacting through traditional marketing and quieter off-market negotiations. Other transactions involve some favorable debt, either the assumption of lower-rated mortgages or some form of seller financing. In the current environment, many sales are motivated by some challenge. Trades are primarily driven by impending financial events, particularly debt coming due. Renovation needs, high insurance costs and declining profitability are pushing assets to market. These categories of seller motivations imply that pricing is less than optimal. Concurrently, those sellers who do not need to sell (particularly those with lower-cost debt) remain off the market. A summary of U.S. hotel transaction volume between 2005 and[1] <u>mid-year</u> 2024 can be found below:

*Table on following page.*

[1] Blue represents limited-service hotel volume while Red represents full-service hotel volume.

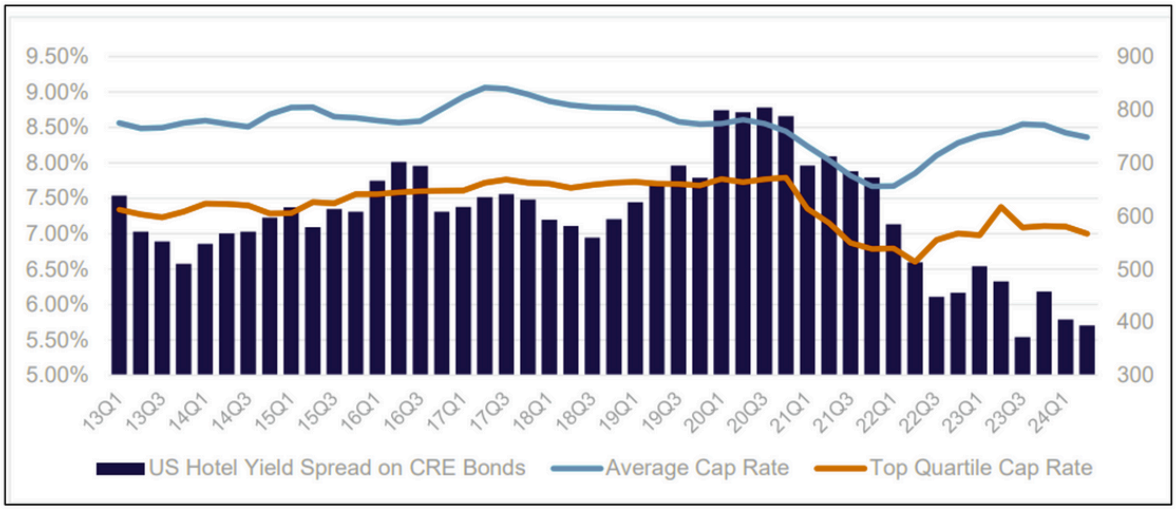



Market participants continue to cite the challenges of high interest rates, particularly as revenues and profitability are moderating. Smaller local and regional banks are reported as being more receptive to hotel lending through relationship accounts. The transfer of debt also continues to be pursued by lenders and investors as an alternative to hard asset transactions.

Consistent with the first half of the year, high interest rates and challenges in sourcing debt contributed to large bid/ask spreads that limited investment transaction activity overall. Unless sellers were particularly motivated, few assets were offered for sale and fewer sold. Sellers who had older debt with favorable terms sought to benefit from the recovering performance in 2023. The large bid-ask spread resulted in very few transactions and many hotels were withdrawn from marketing efforts during the year.

Low-cost available debt is the fuel of the hotel investment market, which has been in short supply over the last two years. The high-cost debt market has suppressed acquisition, refinancing, and property improvement plan ("**PIP**") financing activity even as performance fundamentals were improving. Debt investors were busy amassing funds for preferred and mezzanine deals but were relatively inactive. Hotel franchisors and operators stepped in to fill some gaps for owners with fee waivers and PIP deferrals. Market participants are expressing a growing belief that even with a wave of commercial mortgage-backed securities ("**CMBS**") financings coming due, distress across commercial real estate will remain relatively contained to the poorest performing assets.

Continued increases in interest rates have kept capitalization rates ("**cap rates**") relatively high, as seen in the following chart. However, cap rate growth has begun to at least plateau in the sector. Since reaching a peak at 8.55% in the third quarter of 2023, the average hotel cap rate has compressed by 29 basis points ("**bps**"). Cap rates for top quartile product have similarly compressed by 38 bps since their peak. Yield spreads remain relatively low compared to historical levels, hovering around 400 bps.




The ongoing efforts by the Federal Reserve (the "Fed") to combat inflation over recent years have caused debt to become more expensive and less available, precipitating a cap rate rise across all asset classes. With short term rates at 400 to 500 basis points above the level found during early 2022, many investors have reset expectations, resulting in less aggressive bidding and higher cap rate expectations. In the second half of 2024, the Fed began cutting the target rate for the Fed funds rate (i.e., by 50 bps in September 2024, by 25 basis points in November and by another 25 bps in December 2024 to a range of 4.25% to 4.5%). The November Fed meeting notes indicated inflation is making progress towards the committee's 2% inflation goals, however, the Fed noted the committee seeks to achieve maximum employment and inflation at a rate of 2% over the long run. The latest Consumer Price Index ("**CPI**") report, published February 12, 2024, showed consumer prices increased 3.0% in the trailing 12 months ("**TTM**") ending January 2025, an increase over the TTM period ending December 2024, in which CPI was 2.9%; however, the rate of increase was down significantly from the June 2022 peak of 9.1%. While future rate cuts remain uncertain, the anticipation is for lower borrowing costs in 2025.

# Oil & Gas Developments

In 2024, we covered fourteen (14) sponsor companies which operate within the upstream ("**E&P**") oil/gas sector and raise money from retail investors. This group collectively funded 24 private oil/gas programs that raised $1.441 billion to support drilling and E&P infrastructure, mineral interest acquisitions, and related projects. This represented a 17.50% year-over-year increase in capital funding from what was reported by these sponsors in 2023 (i.e., $1.226 billion). This also resulted in the highest capital raise year from the E&P sponsor group that we cover (i.e., since 2005).

Leading the way in terms of fundraising was U.S. Energy Development Corp. ("**U.S. Energy**"), at $678 million, which was followed by MDS Energy ("**MDS**"), at $197 million, and Mewbourne Development Corporation ("**Mewbourne**"), at $180.0 million. Collectively, and as was the case in 2023, these three sponsors accounted for approximately 73% of the capital raised by the E&P sponsor group we cover.

In terms of funding growth, about 50% of the sponsors from the E&P group reported either year-over-year gains in fundraising or stayed at about the same capital raising level as compared to 2023, which helped to continue the capital raising momentum that was established in 2021-2022 after the headwinds of COVID began to loosen their grip (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 on following page.*

**Table 1- Capital Raised**

| Company | Strategy | 2024 Raise | 2023 Raise | 2022 Raise | 2021 Raise |
|---|---|---|---|---|---|
| Mewbourne | *Drilling*-Horizontal Wells in the Permian Basin and Anadarko Basin | $180.0 MM | $180.0 MM | $250.0 MM | $119.80 MM |
| MDS | *Drilling*-Horizontal Wells in the Marcellus Shale Play | $197.0 MM | $196.0 MM | $225.0 MM | $146.92 MM |
| STL | *Drilling*-Marcellus Shale of East Pennsylvania | $25.0 MM | $31.0 MM | $42.50 MM | $29.50 MM |
| U.S. Energy | *Drilling*-Permian Basin, Powder River Basin, and Haynesville Shale Play; the QOF is an Opportunity Fund Seeking to Acquire Working Interests and Other Upstream Assets | $510.67 MM drilling; $102.0 MM QOF; $12.51 MM 1031 program; $53.08 MM Private Credit | $388.0 MM drilling; $80.0 MM QOF; $15.0 MM 1031 program | $267.93 MM drilling; $56.65 MM QOF; $8.10 MM 1031 program | $145.0 MM drilling; $45.0 MM QOF program |
| Waveland | *Opportunity Fund* Targeting Minerals and Non-Operated Working Interests in the Bakken Shale | $67.49 MM | $94.48 MM | $42.64 MM | $13.26 MM |
| Resource Royalty | *1031 Program* Acquiring Minerals and Royalties in STACK Play of Oklahoma | $17.15 MM | $29.59 MM | $32.90 MM | $11.07 MM |
| Montego Minerals | *1031 Programs* Acquiring Minerals and Royalties in the Permian Basin and East Texas | $67.49 MM | $77.0 MM | $62.20 MM | $19.73 MM |
| White Hawk Energy | *Royalty Fund* Acquiring Mineral Rights, Royalties, and Overriding Royalties | $20.40 MM | $21.20 MM | $65.70 MM | NA |
| King Operating | Sponsors Drilling and Leasehold Acquisition Programs | $81.63 MM | Not Covered | Not Covered | Not Covered |
| Texakoma Resources, LLC | *Drilling*-Granite Wash Play in Tex. Panhandle; Horizontal Drilling for Oil/Nat. Gas | $26.30 MM | $32.0 MM | $30.00 MM | $20.00 MM |
| Texas Standard Energy | *Drilling*-Barnett Shale Combo Play in N. Tex.; Horizontal Drilling for Oil/Nat. Gas | $38.0 MM | $40.0 MM | $4.0 MM | NA |
| RG Partners Fund | Value-added workover and recompletion of leaseholds and oil production in north and east Texas | $42.0 MM | $2.0 MM | NA | NA |
| Unspecified | Two additional Reg. D sponsors also collectively raised equity for Mid Con. Based E&P projects | $1 MM | $40.28 MM | NA | NA |
| Totals | | $1.442 bil. | $1.226 bil. | $1.088 bil. | $550.27 mil. |

## 2024 E&P Capital by Strategy

| | |
|---|---|
| Total Capital: | $1.442 bil. |
| Contributing Sponsors: | 14 |
| Drilling: | $995 mil. (69%) |
| Opportunity Funds: | $329 mil. (23%) (including a QOZ fund) |
| Minerals/Royalties: | $118 mil. (8%) (most structured as direct interests) |

Eleven Internal Revenue Code ("**IRC**") Section 1031 ("**§1031**") eligible programs were wholly or partially funded in 2024 by Resource Royalty, Montego Minerals, and U.S. Energy. These sponsors combined to raise close to $100.0 million. In addition, White Hawk Minerals LLC continued the syndications of its common and preferred share offerings, raising close to $20 million. Based upon relatively stable oil pricing (2023-2024), as well as longer-term natural gas market developments, we think the royalty sponsor segment will hold serve in 2025.

In addition to the capital raised, as reported above, we reviewed a couple of sponsors that are expected to syndicate their first full year of retail fundraising in 2025. These sponsors include Mountain V Oil & Gas (east Kentucky oil recompletions and formerly in the retail market from 2004-2009), Trellis Energy (non-operated drilling program), Rising Phoenix (royalty acquisition program for RIAs), Purified Resources (non-operated drilling program in Bakken Shale Play), and Matrix Petroleum, LLC (operated Eagle Ford Shale drilling program). In addition to these new sponsors, we have recently entered into engagements to review Eagle Eye Funds, as well as an RIA-focused leasehold acquisition and drilling program to be sponsored by King Operating.

Needless to say, it will be an incredibly interesting ride for the sponsors we review in 2025 and 2026, with natural gas markets presently expecting some upside; at the same time, oil prices are expected to remain at or possibly slightly below the levels we observed through most of 2023 and 2024 (with a broader $60-80 bbl price range expected by the E&P companies that responded to the Federal Reserve Bank's most recent activity survey). As we have stated in our last few YE reports, cautious underwriting of a program's costs, risks, and rewards will be more important than ever going into 2025-2026.

## DST Trends Q4 2024
## Mountain Dell Consulting

Despite the continuance of lending headwinds in real estate last year, fifty (50) DST sponsors raised $5.659 billion in equity across 93 programs in 2024.

The top DST sponsors in terms of capital raised were Ares Real Estate Exchange ($1.022 billion, 18% of the DST market), followed by JLL Exchange ($566 million, 10%), Inland Private Capital ($563 million, 10%), Hines Real Estate ($403 million, 7%), ExchangeRight Real Estate ($397 million, 7%), Cantor Fitzgerald ($292 million, 5%), NexPoint Securities

($241 million, 5%), and Capital Square Realty Advisors ($177 million, 3%). These eight companies accounted for over 65% of the DST capital raised last year.

In terms of available equity, industrial assets continue to account for the highest percentage of the DST equity (29%), which is closely followed by multi-family assets (28%), office (9%), and retail (9%). Additionally, medical office, senior housing, and student housing represent 8%, 7%, and 5% of the 1031 equity available for purchase. 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 | Avg. Loan to Value | Days on Market | Cash on Cash |
|---|---|---|---|---|
| Oil & Gas (1) | $20.25 million Two reported deals | No Leverage | 17 | 9.0% |
| Hospitality | $4.563 million One open deal | No Leverage | 47 | 6.01% |
| Industrial | $688 million 21 open deals | 24% | 308 | 4.63% |
| Multi-Family | $659 million 25 open deals | 39% | 370 | 4.57% |
| Multi-Student Housing | $125 million Four open deals | 38% | 159 | 4.69% |
| Office | $215 million Five open deals | 29% | 633 | 5.64% |
| Office/Medical | $178 million Six open deals | 26% (2) | 145 | 5.01% |
| Retail | $211 million 20 open deals | 17% (3) | 329 | 5.23% |
| Self-Storage | $69 million Six open deals | 10% (4) | 254 | 4.76% |
| Senior Housing | $158 million Three open deals | 16% (5) | 209 | 5.52% |
| Farmland (6) | $4.331 million One open deal | 0% | 386 | 3.0% |

(1) Oil & Gas 1031s are structured as fractional interest programs
(2) Average debt affected by three deals with zero leverage
(3) Average debt affected by 13 deals with zero leverage
(4) Average debt affected by five deals with zero leverage
(5) Average debt affected by two deals with zero leverage
(6) Sponsored by DST Farmland

Of the 93 I.R.C. §1031 deals that were open at the end of Q4 2024, the average days on the market was 317 and the average year-one cash on cash return was 4.94%. Also, of the open products on the market, about 50% (i.e., 46 of 90 deals) report that they are all cash, with no leverage used. Of the deals that are using leverage, a majority are using it at loan-to-values from 30% to 55%.

## Upcoming Events Calendar

**ADISA 2025 Spring Conference**
March 31-April 2, 2025
InterContinental Los Angeles Downtown

**2025 Mick Law Energy & Global Alts Symposium**
May 18-20, 2025
Marriott at Legacy Town Center, Dallas/Plano, TX

**2025 Mick Law Real Estate Symposium**
October 19-21, 2025
Westin Tempe, Tempe, AZ