Mick Law P.C.

Navigating private investment opportunities in challenging times

A conversation with

Bradford Updike, LLM, director at Mick Law, as well as Grant Mathey III, JD, and Alan Lincoln, CCIM

We recently had the pleasure of speaking with the due diligence team at Mick Law, P.C., a law firm based in Omaha, Nebraska, that provides underwriting and due diligence support to a network of more than 300 broker-dealers, investment advisers and family offices. Our interview covered market developments affecting private investors of nontraded real estate, energy and private equity programs. Our interview also covered opportunities that private program investors might consider today within each of the three economic segments.

Multifamily assets have historically dominated the retail and institutional sectors of finance in terms of capital raising. Where is multifamily now and where do you see it in 12 months?

Alan Lincoln: Multifamily is still a strong play in almost all market conditions. If you look at returns historically, multifamily has generated some of the strongest returns over the past few decades. The asset class has had stable growth, limited downside years, and is the only asset class you can get Fannie Mae/Freddy Mac 10-year fixed-rate financing with a 30-year amortization schedule. This has helped boost returns and will continue to benefit current investors during turbulent financing times. Further, the asset class has performed remarkably well over the last two economic cycles, having been the benefactor of strong rent growth and cap rate compression. In the next 12 months, we should see an easing of recent downward pricing trends; however, rent growth will slow from record levels and renter demand will taper off slightly.

With interest rates and inflation being where they are today, are there certain sectors of real estate that are performing better than others?

Lincoln: The short answer is "not really." On the investment sales side, the majority of buyers and sellers are "holding off" for now. Saddled with more expensive debt, buyers are unhappy with current cap rates and returns. Meanwhile, sellers have been unwilling to accept higher cap rates, so the bid-ask spread is wider than it has been in a decade.

From an existing portfolio perspective, anyone with short-term leases (e.g., student housing, multifamily, self-storage) is in a much better position to take advantage of inflationary rent growth. Also, interest rates will really start to take a toll over the next 12–24 months as existing debt comes due. Many assets will have trouble meeting the basic lending standards (i.e., debt service–coverage ratios and loan-to-value requirements, etc.).

How do prospects look in the oil/gas space?

Bradford Updike: Despite the headwinds from left-leaning politicians and environmental groups seeking to displace fossil fuels with renewables (i.e., with Bidenomics favoring solar and wind), the U.S. energy and production (E&P) sector has managed to "hold its own" in terms of gradual production growth, as demonstrated through an increase in U.S. daily oil/gas production over the past year. However, as was the case prior to COVID, the fortunes of crude producers will continue on a roller-coaster ride into 2024, as oil prices, which reached $130 per barrel (bbl) WTI in May 2022, have stabilized within a range of $65–$85 bbl WTI over the past 9–10 months. While opinions can vary, we look for Wall Street's ESG and capital discipline mandates to keep U.S. crude production generally in check and oil prices within the range just discussed through the 2024 election. This creates opportunities for private companies and funds to get into Tier 1 drilling projects in basins where economics are still favorable.

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 in January. Notwithstanding, the need for U.S. natural gas in Europe and abroad on a long-term scale should help to present opportunities for better pricing into 2024, 2025 and future years.

As is the case in real estate today, are there headwinds to think about for those that are looking to invest privately in oil/gas?

Updike: One of the more favorable aspects of retail-oriented oil/gas investment programs is that they don't use a lot of debt to acquire the underlying leaseholds or mineral rights. That said, cost inflation has been a major consideration for drilling programs. For example, a 1.75-mile directional well in the Permian Basin that cost $6 million to drill pre-COVID will cost about $10 million to $11 million today. As such, the need to be *incredibly* cautious in underwriting

these projects is crucial, especially within retail syndications where offering fees and sponsor management fees affect investor-level returns.

Despite cost inflation, the appetite in the retail sector for oil/gas drilling opportunities was good in 2022 based upon the capital raised, and we expect that trend to continue into 2023 as inflationary forces begin to wane within the E&P equipment and service sectors. Despite capital raising being down in conventional real estate/DSTs, we'd mention that sponsors of royalty interest programs with a 1031 exchange option are doing well and are funding deals at about the same pace as last year (e.g., Montego Minerals, Resource Royalty, U.S. Energy Development Corp.).

Now that we've discussed oil/gas, let's shift over to renewable energy. Are there any notable opportunities for private investors?

Updike: As renewable energy's share of the world's power grid is slowly growing, we anticipate gradual growth over the next couple years. The challenge is that many of the viable renewable energy projects end up being funded by institutional players and family offices, which means there are fewer opportunities that make economic sense for the retail sector of finance.

Notwithstanding, we know of a few private opportunities, which include a nontraded bond offering sponsored by E2Companies (i.e., micro-grids for primary and secondary power), as well as multiple private offerings that utilized solar development as a component of a conservation easement or fee simple charitable deduction–oriented program. We are also aware of companies that offer solar development project investments for institutional clients and some higher-net-worth investors (e.g., Sixty West, which offers opportunities through Renewable Energy Alternatives).

What is happening in private equity today?

Grant Mathey III: The private equity industry continues to face numerous challenges through midyear 2023. Hopes for a return to strong market fundamentals in 2023 have instead been met with a persistent inflationary environment, pressure on public equities, geopolitical tensions, and complex and onerous new laws and regulatory proposals. Given these conditions, fundraising has become as competitive as ever, and sponsors are battling for capital from investors who are struggling with the lack of liquidity in their portfolios. Coupled with fundraising struggles, M&A activity has failed to pick up at the midyear point of 2023. The industry has yet to rebound from the post-COVID aftermath experienced in 2022. While certain sectors have seen some deal activity, total private equity deal volume for the first half of 2023 has returned to pre-COVID levels, which hit a three-year low in the first half of 2023.

As the investment minimums for most private equity funds are significant (i.e., $1 million to $2 million, plus), are there opportunities for retail investors that want some exposure to this sector?

Mathey / Updike: This year, Seedbrite Ventures released a growth-oriented private equity program that will focus on funding equity participations in venture capital opportunities and startups. The fund is leveraging the capital gains tax exclusion set forth in IRC §1202 for corporate-structured companies with assets less than $50 million. The primary feature of the fund is that it helps facilitate a retail investor's exposure to venture capital through a lower minimum investment commitment (i.e., $25,000), as well as a complete forgiveness of capital gains tax with respect to the fund's portfolio investments if held for five years. Some other private equity opportunities we know of include: (i) Triton Pacific Capital Partners, which offers a fast food–ocused fund as well as a REIT (through its Tasty Brands platform); (ii) Panther Plus Growth Fund II, which was formed to invest in a portfolio of co-investments in private equity and/or loans originated by and managed by its sponsor, Lateral Investment Management; (iii) InvestX Growth Equity IV-US, which has an investment strategy focused on late-stage private companies; (iv) Donovan Ventures, which in addition to its oil production programs also sponsors an energy-focused private equity fund; and (v) Addicus Private Equity, an investment firm that offers investments in solar energy, as well as private equity.

Mick Law, P.C., based in Omaha, Nebraska, is a specialty law firm focused on broker-dealer, registered investment adviser, family office and bank/trust company representation, as well as real estate finance. The firm's due diligence representation includes reviewing and opining on offerings of various asset classes encompassing: DSTs, real estate equity funds, REITs, qualified opportunity zones (QOZ), cryptocurrency, oil and gas/alternative energy, private equity, development/conservation, life settlements, equipment leasing, managed futures, and hedge funds.

The firm provides clients individualized legal opinions with an additional focus on project and fund structure, financing, valuation, and exit analysis. We believe our experience allows us to assist our clients by understanding not only what the regulators require, but more importantly how a direct private placement product compares to its peer group and the likelihood of program performance.

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