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The DOL's Retirement Security Rule:

A Flawed Approach to Protecting Savers

| ADISA's Return on Investment | Why Not All Private Credit Funds Are Created Equal | DST to UPREIT Transactions | Financial Wealth vs. Financial Wisdom | Rethinking the Instruments of Private Wealth | ADISA News



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ADISA's Return on Investment

By John Harrison, DBA,
ADISA Executive Director

A shortcut to remembering all the formulas from finance class was that any formula titled “return on...” meant that a figure for net income was probably in the numerator: return on total assets, return on equity, return on sales—and, of course, the most used of all, return on investment (ROI). For a non-profit entity like ADISA, the math is pretty simple: if there is any return at all (i.e., one dollar more than break even), then all bills are paid and a little is put into reserves.

For ADISA members though, the math can be more difficult: what is a member’s ROI for participation in ADISA? See the ROI Calculation for Average ADISA conference on the opposite page.

The bottom line for each category can be ballpark estimated below. To save space, just assume gain over cost, and the costs are the known out-of-pockets from the table to the right (your time and overhead costs are your own calculation, of course):

1. Associate Members. A qualitative measurement with minor out-of-pocket costs.
(Knowledge/product gain on alts + networking + prof. development) / (time and airfare). Assuming travel costs of about (~\$600 each)

2. Sponsors. A qualitative and quantitative measurement of return over predictable quantitative costs.
(Networking with distribution chain + industry info + exposure) / (time + travel + entertainment + medium booth)
= On avg exposure to about 400 BD/RIA/IARs interested in alts at a cost of about \$20k, or **about \$50 per potential distributor**
(Exposure of thousands of impressions + potential sales + industry knowledge) / (time + travel of 2 for \$2,100 +

booth of \$14k which includes 2 registrations + \$2k booth maintenance + 1/3 membership of \$6,500 + food @\$800)

3. Affiliates. A qualitative and quantitative measurement of return over predictable quantitative costs.
(Networking with potential customers + industry info + exposure) / (time + travel + entertainment + medium booth)
= On avg exposure to about 400 BD/RIA/IARs and about 400 sponsors interested in alts (assuming max target) at a cost of about \$20k, or **about \$25 per potential client**
(Exposure of thousands of impressions + potential sales + industry knowledge) / (time + travel of 2 for \$2,100 + booth of \$14k which includes 2 registrations + \$2k booth maintenance + 1/3 membership of \$6,500 + food @\$800)

What is not included in the above is the considerable industry gain from ADISA’s unparalleled advocacy work in both legislation and regulation and our other industry educational efforts (e.g., Guide to Alts). ADISA’s job is to ensure the continued growth of the industry through all our activities. And that’s a return we can all invest in.

| Attendance/Member Category | Benefits (for avg ADISA conf) | Costs (for avg ADISA conf) |
|--|---|---|
| Associate Member (BD, RIA, IAR, Rep, Adviser) | <ul style="list-style-type: none">• Latest industry trends, data, and updates• Exposure to new (>10) and existing investment products and sponsors (>100) in alts space• Exposure to latest technology, due diligence, and legal suppliers (>100)• Leg/reg updates explained by experts• BD or RIA only discussion groups• Access to exhibit/speaker information and Product and Services Directory (>234)• Practice mgt sessions (~3)• Education sessions (> 30 sessions)• Networking with peers and suppliers (> 8 hrs)• Committee opportunities (≤2)• Access to conference presentations• Hotel nights (up to 2 comp)• Networking food and dine arounds | <ul style="list-style-type: none">• Time (travel + attendance), approx. 2.5 days• Airfare/transportation (~\$458)• Food/etc. not covered elsewhere (\$110) |
| Sponsor Member (investment product issuer) | <ul style="list-style-type: none">• Exposure to new and existing distributors. From 3500 to impressions (350 pp x 4x/day x 2.5 days) and more per exhibit level (top level of approx. 7000 enhanced impressions)• Exposure to latest technology, due diligence and legal suppliers (> 100)• Email blasts to attendees• Leg/reg updates explained by experts• Info on competitors, market landscape and trends• Inclusion in Product and Services Directory (> 2500 readership)• Eligibility to apply to speak in education sessions (> 64 avg attendance)• Eligibility to submit byline articles in AIQ• Networking with peers and distributors (> 8 official hrs)• Committee opportunities (≤2)• Networking food and dine around hosting opportunities• Opportunity for a la carte impression upgrades (exhibit, ads, specialty items, etc.)• Conference passes to distribute to Associate Members | <ul style="list-style-type: none">• Annual membership of \$6500 (grants membership pricing to all events)• Exhibit fees ranging from \$9k to \$40k)• Registration fee from \$0 to \$1500, depending on exhibit level• Booth costs (booths, premiums, shipping, etc.) from \$0 to \$2k (assumes existing booth maintenance)• Time (travel + attendance), approx. 3 days• Airfare/transportation (~\$458)• Hotel from \$580 (2 nts x \$290/nt)• Extra food & entertainment (\$800) |
| Affiliate Member (Industry supplier – legal, technology, 3rd party DD, etc.) | <ul style="list-style-type: none">• Same benefits as sponsor above except greater number of impressions if target market includes both Associate Members and Sponsors | <ul style="list-style-type: none">• Same costs as Sponsors except Annual Membership from \$1k to \$3k |



DOL’s Retirement Security Rule: A Flawed Approach to Protecting Savers

By John Grady, Co-Chair, ADISA Legislative &
Regulatory Committee

Also published in *The DI Wire*
In addition to serving as ADISA’s Legislative &
Regulatory Committee co-chair and ADISA’s
President-Elect, Grady has 30+ years of
investment management experience and
serves as ABR Dynamic Funds’ chief operating
officer and general counsel.

As co-chair of ADISA’s Legislative & Regulatory Committee, I have closely followed the Department of Labor’s (DOL) efforts to finalize its “Retirement Security Rule: Definition of an Investment Advice Fiduciary,” RIN 1210-AC02, or as its more simply known—the DOL fiduciary rule. The final rule was released on April 23rd and will become effective later this year on September 23rd.

The stated aim of this rule is to revise the definition of an “investment advice fiduciary” under the Employee Retirement Income Security Act (ERISA), to capture and subject to the statute’s duties,etc., a larger swath of advice providers who serve retirement accounts. In particular, the amended definition would, as acknowledged by the DOL, subject many broker-dealers that are making or presenting investment options and programs to retirement account clients to the full panoply of duties and obligations placed by ERISA on fiduciaries. While the stated goal of protecting retirement savers is commendable, the final rule raises significant concerns that go far beyond the initial concerns expressed during the rulemaking process and in our view may well result in major unintended ramifications.

Firstly, in revising the definition of investment advice fiduciary to include broker-dealers providing advice and guidance regarding investment options to their retirement saver clients, the rule may negatively impact low- and middle-income Americans, particularly those struggling to close the wealth gap. Subjecting broker-dealers to onerous duties under ERISA when serving retirement saver clients will require some firms to increase their minimum account size while it will push others to raise their fees or simply stop serving the small saver market. Studies carried out following the implementation of the 2016 fiduciary rule, such as the one conducted by the national accounting firm Deloitte, paint a concerning picture—that study revealed that 53% of financial institutions limited or eliminated access to brokerage guidance for retirement accounts, impacting more than 10 million accounts and

In revising the definition of investment advice fiduciary to include broker-dealers providing advice and guidance regarding investment options to their retirement saver clients, the rule may negatively impact low- and middle-income Americans, particularly those struggling to close the wealth gap. Subjecting broker-dealers to onerous duties under ERISA when serving retirement saver clients will require some firms to increase their minimum account size while it will push others to raise their fees or simply stop serving the small saver market.



Furthermore, the DOL's rushed process surrounding the rule raises serious questions about its commitment to a thorough and transparent regulatory process

\$900 billion in assets under management. Similar consequences may be anticipated with the current rule, potentially exacerbating existing financial inequalities.

The Hispanic Leadership Fund's research underscores this concern. Its findings demonstrate that the rule would disproportionately harm Black and Hispanic retirement savers, potentially reducing their accumulated IRA savings by 20% over a decade and further widening the wealth gap. This outcome directly contradicts the intended purpose of protecting vulnerable populations. Studies show that results are improved when savers, particularly small balance savers, get help with their retirement account investments. The new rule threatens to push things in the wrong direction for this important and historically underserved community.

Furthermore, the DOL's rushed process surrounding the rule raises serious questions about its commitment to a thorough and transparent regulatory process. The comment period of only 60 days, compared to 119 days for the 2010 version of the rule and 105 days for the 2015 proposal, was historically short. Additionally, the DOL made the unprecedented move of holding a hearing in the middle of that period, further limiting stakeholder input and the ability to address concerns raised in comments.

Overall, the rulemaking process appears to have been captive to political deadlines and considerations, rather than a desire to craft sound policy. The tight timeframe seems solely focused on ensuring the rule is not subject to a Congressional Review Act vote in 2025, raising concerns about prioritizing political expediency over the

well-being of millions of retirement savers. This hasty approach translates into a lack of adequate research on the rule's potential consequences. Both the DOL and the Office of Information and Regulatory Affairs (OIRA) have dismissed public input about the potential "advice gap" that we believe will arise under the revised rule. They have failed to conduct comprehensive studies to understand the rule's impact on various demographics, including small balance savers, older savers, and new savers.

To our thinking, this approach exemplifies a seeming politicization of the regulatory environment, reminiscent of the practices that the Supreme Court recently curtailed in decisions such as *SEC v. Jarkesy* and in bringing so-called "Chevron deference" to an end (*Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.* (1984)). These decisions highlight the court's concerns over what appears to be a trend for regulatory agencies to be overly influenced by shifting political tides. The Supreme Court's prioritization of the rule of law over partisan agendas suggests potential vulnerabilities in the fiduciary rule.

Again, we think that it is important to recognize the positive intention behind the new investment advice fiduciary rule, such as emphasizing the client's best interest when financial advisers recommend rollovers. However, this positive intent is overshadowed by what we think are significant flaws in the rulemaking process and, more significantly, anticipated negative consequences for millions of Americans saving for retirement. Moving forward, there are steps that I believe could be taken in order to help avoid these detrimental outcomes, including:

- **Halt the finalization of the rule.** Further public input and constructive dialogue are essential before implementing a rule with such far-reaching and potentially devastating consequences.
- **Conduct a comprehensive and independent study.** A thorough analysis of the rule's impact on various demographics, including its potential to exacerbate wealth gaps and limit access to essential financial products, is paramount.
- **Prioritize a transparent and inclusive process.** Meaningful stakeholder engagement throughout the rulemaking process is crucial to ensure the final outcome truly serves the best interests of retirement savers.

The DOL's approach to defining who is a fiduciary under ERISA falls short in our view of its intended goal of protecting retirement savers. By neglecting thorough research and public input, the rule risks inflicting significant harm on the very individuals it aims to protect. We demand a more responsible and transparent process that truly prioritizes the long-term financial security of all Americans and not just political expediency. ▲

Both the DOL and the Office of Information and Regulatory Affairs (OIRA) have dismissed public input about the potential "advice gap" that we believe will arise under the revised rule. They have failed to conduct comprehensive studies to understand the rule's impact on various demographics, including small balance savers, older savers, and new savers.

Credit Where Credit is Due: Why Not All Private Credit Funds Are Created Equal

By Nick Stonestreet, *President of Financial Services,
DLP Capital*

Nick Stonestreet is President of Financial Services for DLP Capital, a private financial services and real estate investment firm headquartered in St. Augustine, FL. DLP Capital Sponsored Funds target long-term capital appreciation, high current income, and tax-advantaged wealth for accredited investors. The Funds make impact investments focused on the financing, asset management, and development of attainable rental housing for working families in Sun Belt markets with strong fundamentals. Their track record includes achieving double-digit equity returns for investors in DLP Capital Sponsored funds every year since inception in 2012¹.

In recent years, private credit has evolved from a niche asset class to a darling of the alternative investment space, outperforming several private capital strategies² in 2023. The growth has been meteoric, globally topping \$2.1 trillion last year (with the U.S. accounting for about three-quarters of that volume³). By 2028, Preqin forecasts that number will reach \$2.8 trillion.

With no signs of diminishing interest from borrowers or investors, firms are clamoring to capitalize on the demand. As the market becomes saturated with private debt solutions, let's face it: they can't all be winners. While private credit funds have the potential to strengthen a client's overall portfolio, in today's environment, it's vital that advisors conduct due diligence on these opportunities in the best interest of their clients.

First Things First: Why is Everyone Talking about Private Credit?

While it's grabbing headlines these days, private credit isn't new. Its origin story traces back to the 1980s when the market emerged to offer financing to companies considered too large—or risky—for commercial banks and too small to raise debt via public markets. In the wake of 2008's financial crisis, the private credit market grew, offering solutions for borrowers amid tightened bank financing. 2023, however, is likely to be remembered as the year that launched private credit into the stratosphere.

The interest rate environment of 2023, characterized by unprecedented and frequent rate hikes, proved a catalyst, creating what many in the industry have begun to refer to as a once-in-a-decade lending environment. Banks began to restrict lending to focus on selling hung debt from unprofitable loans, drying up credit markets in the process. Private credit once again emerged as a solution, empowered to lend at higher rates thanks to the dearth of available financing, strengthening the potential return for investors.

Potential Benefits of Private Credit Funds for Investors

As an advisor, you constantly seek ways to add value to your clients’ portfolios, evaluating both the potential benefits and potential risks associated with any investment. Before we examine the potential risks, let’s discuss the potential benefits of private credit funds. As with any investment opportunity, any potential benefits are only as strong as their alignment with your clients’ investment objectives.

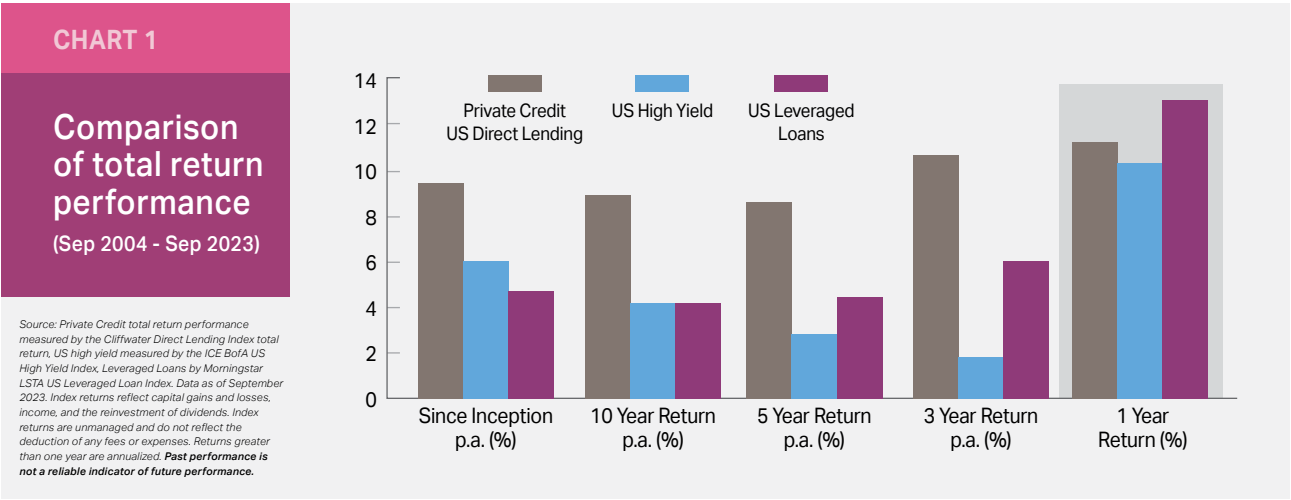
Current Income: Private credit funds are typically structured to target fixed income for investors. Regular distributions are generated based on the interest rates, leverage, and duration of the loans being extended by the Fund, which can make them more predictable than those dictated by profitability, as is the case with equity funds.

Tax Reporting: Depending on their structure, private credit funds may offer investors 1099-DIVs rather than K-1s, which are more straightforward and typically easier for sponsors to distribute. This increases the likelihood that an investor will receive the necessary tax information on time.

Liquidity: Private credit funds are typically fairly liquid and often have a short holding period, giving investors greater flexibility in timing an exit.

Diversification: Private credit funds allow investors to diversify their portfolios away from public markets, mitigating risk from stock market swings and daily volatility.

Return Potential: The historical performance of private credit funds suggests strong return potential for the asset class. See charts 1 and 2 that show private credit outperforming public credit (US High Yield & US Leveraged Loans) between 2004 and 2023 and the S&P 500 from 2000 to June 2023.



Potential Risks and Other Considerations for Private Credit Funds

No investment is without risk and private credit funds are no different. Here are some important considerations when evaluating these funds for your clients’ portfolios.

Borrower Quality & Credit Risk: As their name suggests, private credit funds lend capital to real estate developers and operators. The fund acts as a lender, making up a portion of the capital needed to fund a project. It is not atypical for private credit funds to make loans to below-investment-grade borrowers with challenges obtaining traditional financing. Strong private credit fund managers are diligent in evaluating borrowers and are highly discerning with the capital they lend. Look for firms that are committed to being stewards of investor capital, with a transparent and thorough credit underwriting process that considers a borrower’s experience, history of delinquency or default, and expected recovery rates.

Duration & Liquidity Risk: The mix of underlying assets within a private credit fund can vary in liquidity and duration, which are both key risk considerations. In evaluating a private credit fund, attention should be paid to how the duration and liquidity of the underlying investments compare with the fund structure and terms, looking for any misalignment.

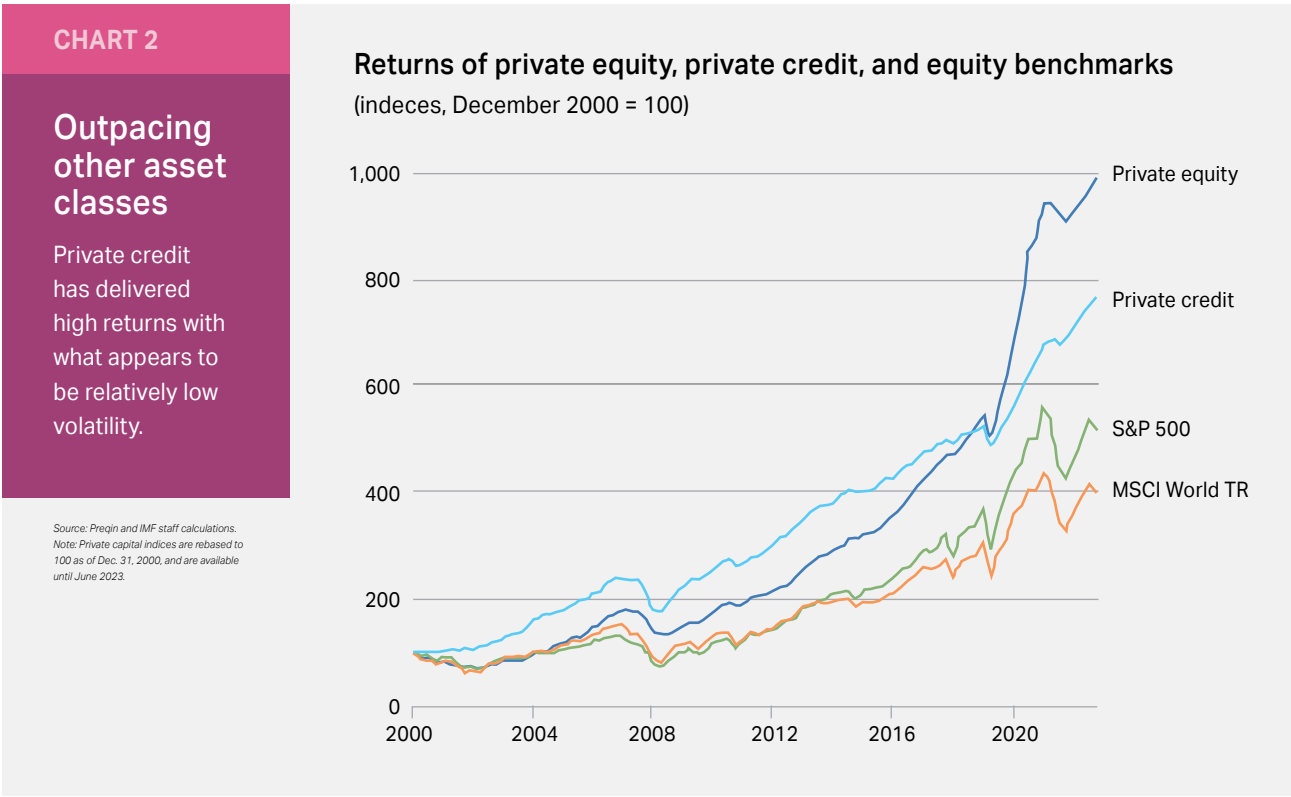
Private credit funds typically hold investments with durations of 5 to 10 years to reflect a corporation’s liquidity or growth needs over time. Evergreen private credit funds are able to hold investments beyond that timeframe, typically without concession on returns or liquidity. From 2006 to 2023, the average spread differential between 2-year and 10-year U.S. government Treasury bonds has been 1.13%⁴, providing an estimate of implied market risks based on maturities of different security types.

In assessing liquidity risk, pay attention to how liquid or illiquid the underlying assets can be during both normal market environments and periods of volatility. A range of premiums based on fund assets relative to freely tradeable assets is reflected in industry research from Robeco and PIMCO. These premiums range from 0.9% for assets that cannot be traded for one year to 4.3% for assets that cannot be traded for 5 years and up to 6% for assets that cannot be traded for 10 years⁵.

Leverage: Despite having some of the highest potential to affect risk, leverage is an area where reporting typically exhibits the most subjectivity, with issues surrounding transparency and lags in matching the debt investment with asset valuation. A larger conversation for the industry is needed to address adjustments to corporate EBITDA, as well as valuation adjustments in new construction and value-add projects to reflect property values, with differences varying greatly from fund manager to fund manager. In evaluating a private credit fund, due diligence should be directed at understanding how the fund manager analyzes and presents this information to ensure clarity, whether fund financials are shared with investors periodically, and annual audited financial statements at a minimum.

Impact Investing VS “Impact” Investing: Spotting the Real Thing

Impact investing has become a buzzword within the private credit market as firms look for new ways to stand out and



attract investors eager for avenues to satiate their philanthropic desires. The absence of regulation around impact investing and the prevalence of greenwashing and impact washing, where companies make unsupported claims about their environmental and social impact to gain favor with investors, can make it hard to spot snake oil. The issue of authenticity in the space is so rampant that it made headlines when global popstar Bono was quoted as saying that impact investing had become “a lot of bad deals done by good people.”

No one wants to put their trust or wealth behind something only to find out they didn't know the full picture. As an advisor, part of stewarding your clients’ wealth is being the expert on the full picture. So what constitutes a true impact investment, and what should you consider in evaluating opportunities for your client?

There’s a misconception in the industry that impact investing is synonymous with ESG; that’s not the case. As defined by the Global Impact Investing Network (GIIN), an impact investment is an investment “made with the intention to generate positive, measurable, social and/or environmental impact alongside a financial return.” There’s an important word in that definition: measurable. True impact investing firms will be able to demonstrate a measurable impact. To this end, they will not only be clear about what they seek to impact and how they intend to do so, but they’ll also have clear metrics identified.

Beyond assessing the authenticity of an impact investment, it’s important to ensure that it aligns with your client’s primary objective. Impact investments generally take one of two approaches: concessionary or non-concessionary investing. Concessionary investing has greater alignment with a philanthropic intent, with making a significant impact taking the primary focus ahead of generating a positive return. Non-concessionary investing takes the opposite approach, emphasizing generating attractive financial returns. It’s important to be clear on the priority for your client when evaluating an impact investing-focused private credit investment for their portfolio.

Lending Can Be a Risky Business: Evaluate Mitigation Strategies

While credit investments put firms in control of the capital, it rarely means they control the project itself. In evaluating private credit opportunities, pay attention to any strategies for risk mitigation. Does the firm have the resources to see a project through if the sponsor unexpectedly pulls out? Looking for vertically integrated firms with operator

experience can offer a welcome layer of risk mitigation.

Remember that not all debt is created equal. A credit investment’s position within the capital stack can significantly affect its position on the risk/reward spectrum and, in turn, levels of risk mitigation. Always remember to be clear with your clients on risk tolerance alignment.

Consider the structure of the private credit fund. Evergreen private credit funds have grown in popularity in recent years—and for good reason. As mentioned earlier, they are structured to hold investments beyond the typical 5-10-year window, typically without concessions on returns or impact on liquidity. This fund structure affords investors several other benefits as well, including an element of risk mitigation from the extended investment horizon, which allows the fund sponsor the flexibility to maximize the timing of lending, without any time-sensitive urgency to deploy capital. Charts 3 and 4 illustrate other key differences between closed-end and evergreen funds.

Track Records Speak (but They Don't Guarantee)

We’ve all read the fine print: past performance does not guarantee future results. Nevertheless, evaluating the track record of a private credit fund’s sponsor is an essential step in the due diligence process for any investment.

With liquidity a potential draw for many evaluating private credit funds, remember to consider the firm’s history with client redemptions. Have they been able to honor redemptions promptly, or have there been challenges? If liquidity is a goal for your investors, you want to ensure the fund manager’s dependability in this area.

Consider their experience as a lender. You want to consider not just their current loan under management figure but also their track record of loans being paid off by those they’ve extended credit to and any delinquencies. Low delinquency rates and a track record of loans being paid off can speak to the fund manager’s experience in underwriting.

Private Credit Fund Takeaways

As challenges in obtaining traditional financing persist for real estate operators and developers, opportunities for private credit fund managers and investors continue to hit the market. Investing in private credit funds can offer investors the potential for current income, favorable liquidity, and portfolio diversification, but not all of these trendy funds are created equal. As an advisor, due diligence is paramount in selecting investment opportunities that not only align with your clients’ risk tolerance and investment objectives but those that are managed by firms with the experience and expertise to navigate this asset class. ▲

Chart Source: Partners Group, Private Markets Mythbusters Series: Navigating the Evergreen Funds Frenzy, April 2024*

| CHART 3 | | | Comparing fund structures |
|----------------------|--|--|---|
| Features | Closed-end fund | Evergreen fund | |
| Access | Investor commits capital during the fundraising period | Investor subscribes over time, usually monthly or quarterly | |
| Fund life | 10-15 years | Perpetual fund | |
| Cash flows | Capital drawn over 3-5 years | 100% invested subscription | |
| Liquidity | Distributions paid to investor once investments are exited, at managers discretion | Investors have discretion to issue redemption requests over time | |
| Distribution policy | Typically paid back to clients after end of investment period | Distributions usually automatically reinvested in new investments | |
| J-Curve ¹ | Net returns can initially be negative during investment build-up | No J-Curve, as investors accesses an already built-up portfolio | |
| Return profile | Net international rate of return (IRR) on drawn capital | Compounded net return on entire subscribed amount | |
| Fund gates | Not applicable | Limits placed on the magnitude of outflows permitted from the fund | |
| | | | <small>1—Trendline that shows a fund's initial loss, typically the first years of the investment period, which is then followed by a dramatic gain in value. Source: Partners Group (2024).</small> |

| CHART 4 | Evergreen strategy average annual returns | | | | |
|---|--|-----------------------------------|------|------|------|
| | 9% | 10% | 11% | 12% | 13% |
| | Primary fund IRR equivalent (uncalled capital in cash) | | | | |
| | 18% | 19% | 20% | 22% | 23% |
| An evergreen strategy's return is equivalent to a higher primary fund return | | Original investment is multiplied | | | |
| | | 2.2x | 2.4x | 2.7x | 2.9x |
| <small>Note: For a given evergreen strategy's return (top row), the required equivalent return on a traditional Primary fund to reach the same dollar-on-dollar multiple (bottom row) is shown in the middle row. Source: Partners Group, as of September 30, 2020. All returns shown are net of fees and expenses. Fund-of-fund capital calls and distributions based on real historical cash flow patterns from Cambridge Analytics and adjusted based on Partners Group's forward-looking expected returns framework. MSCI return used is 8%, which is the average annualized return from the inception of the representative account on 06/20/2009 to 09/30/2020.</small> | | | | | |

1—Past performance is not a guarantee of future performance.

2—Prequin, Private Debt In 2024: What GPs Expect In The Year Ahead, December 2023

3—IMF, Fast-Growing \$2 Trillion Private Credit Market Warrants Closer Watch, April 2024

4—Statista, Monthly Ten-Year Government Bond Yield Minus Two-Year Government Bond Yield Spread In The United States From 2006 To July 2023, August 2023

5—Caia, The Ins and Outs of Investing in Illiquid Assets, May 2016

Chart Source: Partners Group, Private Markets Mythbusters Series: Navigating the Evergreen Funds Frenzy, April 2024

Financial Wealth vs. Financial Wisdom: Rethinking the Accredited Investor Definition

By Damon Elder, *Publisher & Editor-in-Chief, The DI Wire*

Damon Elder is the publisher and editor-in-chief of *The DI Wire*. He has worked in the alternative investments industry for nearly 20 years. He was previously a congressional aide and political consultant before finding honest work in the private sector.



The accredited investor definition is a cornerstone of U.S. securities regulation, playing a pivotal role in who can participate in certain investment opportunities. The U.S. Securities and Exchange Commission has been tasked with reviewing this definition at least every four years to ensure it aligns with investor protection and the broader economic landscape.

Of course, in a free society, why in the world does the government have the right to determine how we can invest our money? Shouldn't we all be empowered to make our own decisions in this regard? Shouldn't the SEC focus on policing, rather than restricting the liberty of free people?

I think the answers to these questions are pretty obvious, but the fact remains that we have, as a society, allowed the government to exercise control over our own free will in terms of our ability to invest where we choose. This is at least until we can establish, by the accumulation of enough wealth, that we are smart enough to invest our own money how we choose by earning the coveted "accredited investor" definition. As such, absent the unfortunately fantastical notion that we as a people would object to the types of bureaucratic control over our financial liberty, we should focus on what can be done to improve the investor definition of an accredited investor so that more Americans can exercise their option to invest in private securities.

Historically, the definition has been based on financial thresholds, including income and net worth requirements, with the idea that individuals meeting these thresholds are financially sophisticated enough to understand and bear the risks associated with unregistered securities

This potential move by the SEC to narrow the definition of an accredited investor is concerning and misguided. Restricting investment opportunities based on wealth is a fundamentally flawed approach that perpetuates inequality and limits the ability of many Americans to grow their wealth through diverse investment options.

offerings. Generally, the guidelines, pursuant to Rule 501 of Regulation D of the Securities Act of 1933, have required an individual to meet at least one of two criteria:

- A net worth exceeding \$1 million, excluding the value of their primary residence, either individually or jointly with a spouse; or
- An annual income exceeding \$200,000 in each of the two most recent years (or joint income with a spouse exceeding \$300,000) and a reasonable expectation of maintaining the same income level in the current year.

The SEC has made several amendments to the definition over the years, most recently in August 2020, expanding the categories of who qualifies. These changes included recognizing:

Individuals who have certain professional certifications and designations;

- Individuals who are “knowledgeable employees” of private funds, but only in regard to that specific fund;
- SEC-registered and state-registered investment advisers;
- Individuals who are “family clients” associated with a “family office,” and who meet specific requirements; and
- Directors, executive officers, and general partners of the issuer or of a general partner of the issuer.

The SEC released a staff report in December 2023, once again reviewing the definition. While the report did not recommend changes, speculation remains that the commission may move toward narrowing the definition, possibly by excluding assets accumulated in defined contribution plans from the net worth calculation and/or adjusting the income and net worth thresholds for inflation. This would mean fewer individuals would qualify as accredited investors, limiting their access to potentially lucrative investment opportunities in the private markets.

This potential move by the SEC to narrow the definition of an accredited investor is concerning and misguided. Restricting investment opportunities based on wealth is a fundamentally flawed approach that perpetuates inequality and limits the ability of many Americans to grow their wealth through diverse investment options.

The very foundation upon which the accredited investor definition is built is offensive. Wealth does not necessarily equate to financial acumen, and the SEC’s arbitrary financial thresholds are an inaccurate measure of an investor’s financial sophistication. Not only do they clumsily group together lottery winners and heirs with those who actively earned their wealth through financial knowledge, but they exclude those individuals who have grown their “financial chops” but have yet to build up substantial savings.

Along these same lines, the exclusion of primary residences from the net worth calculation is illogical. For many Americans, their home is their most significant asset. Excluding it distorts the picture of their true financial standing and unfairly excludes them from investment opportunities.

Additionally, wealth thresholds are insufficient to determine who can “afford” investment losses. Loss tolerance is complex and depends on a number of factors such as age and individual investment goals. Older investors may be more risk-averse than younger ones, and investors may have diverse motivations beyond financial returns, such as supporting local businesses or diversifying their portfolios. The SEC’s definition fails to capture these nuances.

Instead of narrowing the definition, the SEC should focus on expanding access to investment opportunities for all Americans. Some possible methods to accomplish this goal might include the following.

- **An accredited investor exam:** The SEC could develop a specific, comprehensive financial literacy exam or a series of educational modules that, upon successful completion, would grant individuals accredited investor status. This approach would focus on knowledge and understanding of investment risks rather than solely on wealth.
- **Investment track record:** The commission could consider an individual’s investment history. An individual with a proven history of successful investing in public markets could be deemed capable of handling the risks of private markets.
- **A broader regard for professional experiences:** Certain professions, such as lawyers, accountants, or financial analysts require a high level of financial knowledge. The SEC could recognize these professions as qualifying criteria for accredited investor status, as they already do with certain financial certifications.
- **Hybrid model:** The SEC could adopt a hybrid model that combines financial thresholds with other criteria. For instance, an individual could qualify if they meet a lower net worth or income threshold and also pass a financial literacy exam or have relevant professional experience.
- **“Emerging” accredited investor:** A new sub-category of “emerging accredited investor” could be created with lower financial thresholds but limited investment options. This would allow individuals with less wealth to participate in certain private offerings deemed less risky.

These potential alternative definitions would allow further access and help to ensure that individuals who are genuinely knowledgeable and capable of understanding the risks involved could participate in private markets, regardless of their net worth.

The accredited investor definition is a critical aspect of securities regulation that must be modernized. As it stands now, it a tool for exclusion, limiting the ability for middle-income and low-income individuals to amass wealth and diversify their portfolios. This harms both investors and those entrepreneurs who depend on those investments.

Instead, the accredited investor definition can be a gateway to opportunity. By rethinking the criteria and focusing on financial sophistication rather than wealth, the SEC can create a more inclusive and equitable investment landscape for all Americans. Absent a perfect world where we can eliminate such objectionable control over our financial freewill, this may be the best we can hope for. ▲

Loss tolerance is complex and depends on a number of factors such as age and individual investment goals. Older investors may be more risk-averse than younger ones, and investors may have diverse motivations beyond financial returns, such as supporting local businesses or diversifying their portfolios. The SEC’s definition fails to capture these nuances.

Rethinking the Instruments of Private Wealth—Including the RIA Operating Model

By Rizwan Ibrahim, Accretive Wealth Management

Rizwan Ibrahim is director of due diligence and strategy at Accretive Wealth Management, a member of the Real Assets Adviser editorial advisory board, as well as an ADISA member who speaks often on topics relating to RIAs.

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Fundamental change in the macroeconomic environment requires a shift from a reliance on public markets for income and growth to including both public and private investments in client portfolios. Given the traditional focus on public markets, RIAs have to deal with new challenges. Consistent with their fiduciary obligations, RIAs will need to strengthen their portfolio analysis techniques and ramp up their due diligence and training for advisers, while at the same time restructuring their operating models for continued growth and creating better outcomes for investors by advocating in front of sponsors and regulators.

The advent of alternative investments in the retail investment landscape is offering a new way forward for RIAs to serve clients in the face of macroeconomic shifts and a changed environment for public debt and equity. Traditional 60/40 portfolios and the RIA operating model need to be restructured if RIAs are to be relevant in meeting clients' future needs and fulfilling their fiduciary responsibilities.

Traditional portfolio construction is insufficient to meet future investor needs due to fundamental change in the macroeconomic environment, declining prospects for public markets, and exponential growth of private markets.

RIAs have started to look at the benefits of including alternatives in traditional portfolios but face several challenges, both functional and structural, in being able to effectively scale their operating models.

Globally, institutional investors have increased allocations to alternatives. RIAs are starting to see the rationale. They are leaning into alternatives to reduce volatility, support income growth potential and maximize risk-adjusted returns. Alternatives have performed better per unit of risk than traditional assets during the past 10 years. Risk, proxied by volatility, has been higher

Going forward, traditional asset classes may be insufficient to achieve return goals. During the past 10 years, 60/40 portfolios returned an average of about 8 percent. To achieve close to that return over the next five years amid elevated inflation, higher borrowing costs and slower real economic growth, investors will need to diversify away from public debt and equity.

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Most RIAs have succeeded as advisers utilizing the reliability of the 60/40 (60 percent in public stocks/40 percent in public bonds) portfolio. Diversification by investing in assets with low-negative correlation with one another would reduce total portfolio risk. 2022 provided a real-time understanding of how vulnerable the model is to volatility and correlation of financial markets. Going forward, traditional asset classes may be insufficient to achieve return goals. During the past 10 years, 60/40 portfolios returned an average of about 8 percent. To achieve close to that return over the next five years amid elevated inflation, higher borrowing costs and slower real economic growth, investors will need to diversify away from public debt and equity. Access to a broader set of private investment opportunities has never been better to match client assets and future liabilities.

RIAs are faced with questions on several fronts, as they contemplate organizing for future growth in their practices:

Portfolio management: How do you position client portfolios to take advantage of alternatives by matching assets and future liabilities? Should you move your 60/40 to a 50/30/20 (public stocks/bonds/alternatives) or a 50/50 (public/private) portfolio? What data and models do you rely upon to make your portfolio allocations, both strategic and tactical?

Training and education: How do you complement public market experience of advisers and train them to analyze vastly different asset characteristics and risk- return profiles of private investments?

Due diligence: How do you conduct manager and fund due diligence, realizing there is a significant manager performance dispersion within all alternative asset classes? How do you leverage institutional asset managers that have largely served pensions and sovereign wealth funds?

Client management: Can you offer a high-quality experience to clients in the future given more product and portfolio management complexity? How do you explain the illiquidity premium to clients or that semi-liquid is not like going to the bank?

Advocacy: How do you deal with complex regulatory/legal requirements and function as the best fiduciary for clients in front of sponsors and regulators?

Independence: How do you maintain your independence as an RIA in the face of continuing investments in people, technology and back-office support to achieve scale?

RIAs Going Forward

RIAs need to approach alternatives with a new mindset, step up adviser education and training, develop a new analytical toolkit, and focus on manager and fund due diligence. At the same time, RIAs need to advocate for product improvement with sponsors, investor rights on the regulatory front, and restructure their operating models.



Globally, institutional investors have increased allocations to alternatives. RIAs are starting to see the rationale. They are leaning into alternatives to reduce volatility, support income growth potential and maximize risk-adjusted returns. Alternatives have performed better per unit of risk than traditional assets during the past 10 years. Risk, proxied by volatility, has been higher than the average return in both stocks and bonds during the past 10 years, but not for alternatives.



RIA firms have successfully used software to create financial plans and portfolio asset allocations using public market securities. The new world of alternatives now requires blending both public and private assets into a client portfolio.

New mindset: A simple framework to approach any private investment is to think of the investment as a business that an asset manager is running. An investor is participating in the business as a limited partner/shareholder, and benefits if the manager delivers net income from the business.

Portfolio management: RIA firms have successfully used software to create financial plans and portfolio asset allocations using public market securities. The new world of alternatives now requires blending both public and private assets into a client portfolio. This requires using models drawn from institutional managers and other providers that draw the most up-to-date data from both private and public investments, and that are normalized so they can be used accurately. Risk and return data must be available on the same analytical basis if portfolios can be optimized meaningfully. As an example, if public data is updated daily and private data is updated less frequently (yearly or quarterly), the standard deviation calculations can be inaccurate. One needs to account for liquid and illiquid investments, as well as interval and capital drawdown funds on the same basis. When looking at a client's overall investment portfolio, one needs to confirm the alternatives are doing what they are supposed to in terms of the total investment picture—assessing which investments are providing true alpha versus market beta, and making sure a client's portfolio is not overpaying for commoditized investments.

Training and education: What is needed to prepare advisers to represent alternative investments is not a trivial exercise. Whether it is customized in-house programs or drawing upon excellent resources from CAIA and the CFA Institute, platforms such as iCapital and CAIS, or directly from the best institutional asset managers, a formal training is required to upgrade adviser skills typically built on public debt and equity backgrounds. This takes time and effort and depends on the firm's professionalism as well as advisers' motivations.

Manager and fund due diligence: By far one of the most critical areas for RIAs to focus on alternatives is manager and fund due diligence. This is normally the most critical and most time consuming part of offering alternatives in a practice. Think of this as solving the "who, what and how" puzzle. Who is the manager? What is the team behind the offering, their background and investment experience, and their track record? What do they do? Is it private equity (running a private company that delivers a product or service), private credit (providing loans to businesses), real estate (building or improving a piece of commercial or industrial or retail property)? What is the investment thesis (or business strategy)? How does the manager generate value? What is the "secret sauce"? Is it depth and breadth of deal flow, or a rigorous diligence process supported by proprietary tools and proper resources? Particular attention needs to be paid to how distributions and gains are generated. Is organic cash flow generated from the business operations, or is there a Ponzi scheme going on? Is there reasonableness and transparency in the fees and expenses being charged?

From an investor's standpoint, an asset manager fund is attractive if it provides return of the original capital, a reasonable return on the capital (to compensate the investor for the opportunity cost of capital), then shares in the remaining upside of the overall investment. This aligns an investor's interest with an asset manager completely. Every investment opportunity needs to be assessed using this framework.

With the advent of large institutional managers into the private wealth space, new products and share classes are being offered daily. Third-party due diligence firms such as FactRight, Buttonwood, Snyder Kearney and Mick Law can be leveraged by RIAs to provide a critical look at manager operations and investment track records. RIAs specializing in alternatives can have an advantage in terms of due diligence as they have built relationships and have direct access to portfolio managers at the leading asset managers.

More on advocacy: As a fiduciary for clients, RIAs need to function as advocates for industry improvement. This responsibility can be voiced through memberships in industry forums such as ADISA and IPA. For example, RIAs can insist on more product innovation and fee/distribution transparency from sponsors and that for bad actors not be given a stage to market their products. One area for product innovation is to ask for similar returns from interval funds (in private equity, as an example) to that available from drawdown structures. Because capital is put to work immediately and continuously compounds, a lower perpetual offering fund IRR should deliver the same MOIC (multiple on invested capital) as a traditional PE fund with a higher IRR and an opportunity cost of uninvested capital.

On the regulatory and legislative fronts, RIAs can insist on a better "journey" for investors after they invest in an alternative. This is especially relevant when a sponsor runs into a problem or there is a fund manager dispute, when there is a deviation from the investment thesis due to non-performance, or when a sponsor gets into regulatory trouble and has an SEC monitor appointed to provide oversight and eventual liquidation.

Operating model: While independence as an RIA is priceless (you get to do what you want with clients and have nobody to answer to), in the evolving world of private wealth management, especially with the complexity introduced by combining public and private investments, the ability to offer differentiated, quality service to clients is becoming more difficult. Options available are to continue doing it yourself, merge with others, or sell to a network/platform that is consolidating practices and providing customized back-office services (technology, HR, finance, accounting, legal/regulatory, due diligence), so advisers can focus on direct client service. Over time RIAs will need to reevaluate their operating models to remain both effective and efficient in serving their clients.

As RIAs transition to embrace the new macroeconomic reality and its impact on the investment landscape, they will be instrumental in creating rewards and benefits for everyone: better outcomes for investors, higher fiduciary performance for their advisers, and a stable and growing alternatives industry. ▲



As a fiduciary for clients, RIAs need to function as advocates for industry improvement. This responsibility can be voiced through memberships in industry forums such as ADISA and IPA.



DST to UPREIT Transactions: The Next Phase in the Progression of Tax-Advantaged Real Estate Investments

By Louis J. Rogers, *Capital Square*

Louis J. Rogers is founder and chief executive officer of Capital Square, where he oversees the firm's Delaware statutory trust (DST) programs for investors seeking qualifying replacement property for Section 1031 tax-deferred exchanges and regular (non-exchange) investors.

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A new twist on the traditional UPREIT is gaining popularity—the DST to UPREIT transaction.

The Delaware Statutory Trust (DST) structure has become a powerful tool for making tax advantaged real estate investments under Section 1031 of the Internal Revenue Code, which defers taxes when real estate owners sell and reinvest in qualifying replacement property.

The desire for higher quality replacement property with turn-key management is the driving force behind the movement to DST replacement property, especially among older real estate owners who are tired of property management.

There are, however, many structural requirements for a DST to qualify for tax deferral under Section 1031. For example, DST properties must be sold when their mortgage matures, and it's not permissible to recapitalize or refinance, even when it would be in the best interest of investors. Thus, most DST properties must be sold every ten years (when their mortgage matures), even if the owners are happy with their investment or it's an inopportune time to sell.

The DST structural issues, and a number of additional REIT benefits, are leading to a new phase—where DST owners contribute their interests to an UPREIT.

Umbrella Partnership Real Estate Investment Trust (UPREIT). Most REITs own their real estate in an operating partnership that qualifies for favorable partnership taxation. In an UPREIT transaction, owners contribute their real estate to the operating partnership in exchange for operating partnership (OP) units. The same applies for owners of DST interests.

A number of favorable partnership tax rules apply. For example, there is no taxable gain to the contributors (the property or DST owners) or the recipient (the operating partnership) under Section 721. The operating partnership may assume the contributor's mortgage debt or repay it. Contributing owners retain their tax benefits, including depreciation and operating expense deductions.

Importantly, UPREIT transactions allow owners to exchange one property (or interest in a

DST) for ownership in a larger diversified operating partnership portfolio that is professionally managed by the REIT and obtain other REIT benefits.

REIT Benefits. REITs provide a high degree of transparency: typically, a majority of the board is comprised of independent directors, the board approves major decisions and sponsor compensation, and financial statements are audited by a top CPA firm.

REITs provide a liquidity option that is not available under the DST structure. OP holders have an option to exchange OP units for REIT stock that can then be sold, thereby creating liquidity. There is no liquidity in a DST program until the DST's property is sold (typically up to ten years).

Also, the UPREIT structure is beneficial for estate planning and gifting because OP units can be divided and distributed to heirs or partners. Then, each individual OP holder can make their own decision whether to hold, gift or sell some or all of the OP units. The UPREIT structure provides maximum flexibility for estate and gift planning.

Section 1031 does not permit a direct exchange into an UPREIT. To comply, a two-step process is required: first, a Section 1031 exchange into a DST and, later, a DST to UPREIT transaction.

Potential Benefits of a DST to UPREIT Transactions:

- **Increased Distributions:** Distributions typically increase based on appreciated value of the DST property being contributed.
- **Safety Net/Diversification:** DST owners have the safety net of a more diversified investment because the REIT owns a much larger portfolio.
- **Ability to Capture Future Appreciation:** Many DST properties would benefit from additional capital improvements to further increase value beyond funds held in reserves.
- **Transparency:** REITs typically provide a high degree of transparency.
- **Liquidity:** OP holders have an option to sell OP units, thereby creating liquidity that is not available in a DST structure.
- **Retention of Tax Benefits:** OP holders retain their tax benefits, including depreciation and other tax deductions.
- **Long-Term Hold:** Properties can be held long-term versus a sale when the mortgage matures.
- **Ability to Assume Favorable Long-Term Debt:** Ability to assume favorable DST loans.
- **Lower Fees:** Lower fee structure to manage and operate.
- **No Taxable Gain:** These benefits are accomplished without any taxable gain (federal or state) under Section 721.

Conclusion. New structures evolve over time. The DST to UPREIT transaction allows investors to upgrade their single property DST investment for an interest in a diversified portfolio of investment grade real estate along with other REIT benefits, all in a tax-advantaged manner. This progression is affording smaller real estate owners many of the benefits previously only available to institutional (REIT) investors. The DST to UPREIT transaction is the next phase in the progression and institutionalization of real estate. This is an exciting time to be in the real estate business. ▲



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Agenda As of 7/23/2024

MONDAY October 7

11:45 AM - 1:00 PM
Women's & Next Generation
Luncheon

1:15 PM - 2:15 PM
Fundamentals of Alts
Operations/Technology

2:30 PM - 3:30 PM
Energy
Key Deal Terms
Real Estate

3:45 PM - 4:30 PM
Conference Kick-Off

4:30 PM - 5:30 PM
General Session I:
Industry Updates

5:30 PM - 6:45 PM
Opening Cocktail Reception

TUESDAY October 8

8:00 AM - 9:00 AM
Breakfast & Exhibition

9:00 AM - 9:50 AM
General Session II:
Legislative & Regulatory
Updates

9:50 AM - 10:40 AM
General Session III

10:50 AM - 11:40 AM
1031s
Current Market
New Products

11:50 AM - 12:40 PM
Operations & Technology
RIA Topic
Structured Products

12:45 PM - 2:00 PM
Lunch & Exhibition

2:00 PM - 2:50 PM
Infrastructure
Preferred Securities
RIA Topic

3:00 PM - 3:50 PM
Ask a Lawyer
Private Equity
Secondary Market

4:00 PM - 4:25 PM
Break & Exhibition
4:30 PM - 5:30 PM
General Session IV:
Keynote Speaker

5:30 PM - 6:45 PM
Cocktail Reception
& Exhibition

WEDNESDAY October 9

8:00 AM - 9:00 AM
Breakfast & Exhibition

9:00 AM - 10:00 AM
General Session V

10:10 AM - 11:00 AM
Impact Topic
Private Credit
RIA Portfolio

11:10 AM - 12:00 PM
Broker-Dealer Advisory Council
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