Vinson&Elkins

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ENERGY REITS AND REAL ESTATE MLPS

Energy Finance Series

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OVERVIEW
COMPARISON OF REITS AND MLPS

- Total Market Capitalization
  - REITs*: $993 Billion
  - MLPs**: $450 Billion
- Number of Publicly Traded Entities
  - REITs*: 220
  - MLPs**: 147
- History and Growth
  - REITs: 1960 Legislation; Significant Growth 1990s
  - MLPs: 1987 Legislation; Significant Growth 2000s

*Source: NAREIT Website

**Source: MLPA Website

OVERVIEW
COMPARISON OF REITS AND MLPS

- Structural Comparison
  - Yielding Investments
  - No entity level Federal income tax
  - Investor Considerations
    - REITs: Tax Exempts; 1099
    - MLPs: Retail Investors and Closed End Funds; K-1s
  - Governance
    - REITs: Traditional elected board structure
    - MLPs: Controlled General Partners; predominately non-elected directors

REAL ESTATE MLPS

- Landmark Infrastructure Partners LP
- StoneMor Partners L.P.
- CrossAmerica Partners LP
- Sunoco LP
- Plum Creek Timber Company, L.P.; converted to a REIT in 1999
- Rayonier Timberlands, L.P.
- IP Timberlands, Ltd.

THE ART OF THE POSSIBLE
REITS

REIT Qualifying Income

- Rents from qualifying real property
- Interest on mortgages on qualifying real property
- Capital gains from sales of the above

THE ART OF THE POSSIBLE
REITS

<u>What is qualifying real property?</u>

- Real Property
  - Land—includes fee, leaseholds, easements/rights of way
  - Inherently Permanent Structures (IPSs)
  - Structural Components of IPSs (but only if included with IPS)
- Passive Nature
  - Must serve a passive function and not active function
- Qualifying Non-Real Property
  - Associated Personal Property
- Use of TRS for Non-Qualifying Assets and Income
  - Investment in TRSs cannot exceed 25% (soon to be 20%) of gross assets

THE ART OF THE POSSIBLE
REITS

What energy/infrastructure assets potentially qualify?

- Transmission lines, pipelines, offshore drilling platforms
- Electric Transmission/Distribution Systems
- Storage structures (including silos and oil and gas storage tanks)
- Renewables
  - Roof top sites, easements/leases, site pads
  - Mounts, wires and other permanent fixtures may qualify
- Railroad assets
- Terminals
- Salt Water Disposal Wells

THE ART OF THE POSSIBLE
REITS

<u>What energy/infrastructure assets will not qualify?</u>

- PV Modules in solar energy sites
- Wind turbines
- Meters and compressors in a pipeline transmission system
- Temporary drilling platforms

THE ART OF THE POSSIBLE
REITS

<u>What is rental income?</u>

- Operating Lease
  - Lease must qualify as an operating lease and not a capital lease under tax rules
  - Capital leases will not produce rental income, but may produce qualifying REIT income. Viewed as debt for tax and evaluated under mortgage rules for REITs
- Related Party Tenant Prohibition
  - Tenant cannot be materially related to REIT (no overlapping 10% or greater owners)
- Prohibition on Rents based on Net Income
  - Rent can be based on gross income

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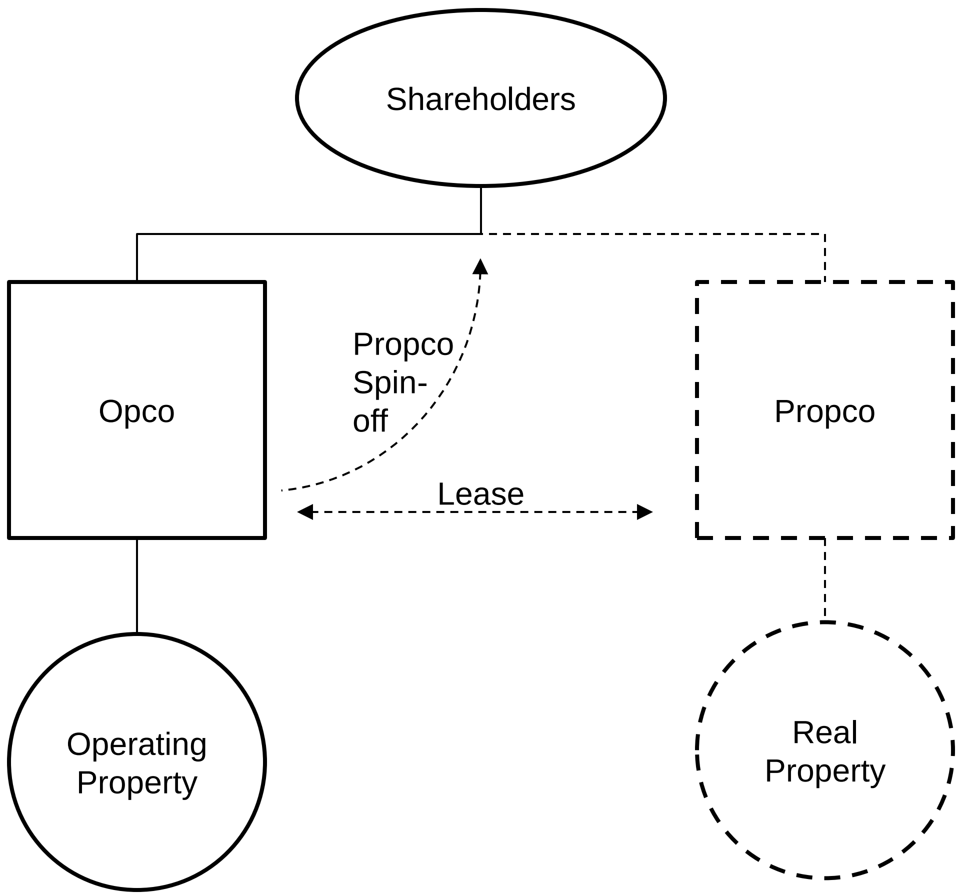
THE ART OF THE POSSIBLE
REITS

What structures can be facilitated with a REIT?

- Propco/Opco Spin-Off
  - PATH Act prohibition on tax-free REIT spin-offs
- Sale-Leaseback
- Drop-Down/Contribution
- Mortgages
  - Third Party Loans
  - Loans to TRSs
- C-corp conversions
  - Impact of Temporary Regulations on C-Corp conversions

POTENTIAL REIT STRUCTURES
SPIN-OFF



- Corporation engaged in real estate intensive business ("Opco") contributes real property assets to new subsidiary ("Propco")
- Opco distributes stock of Propco to public in a tax-free spin-off
- Propco elects REIT status
- Could also be structured as Propco spin-off of Opco
- REIT spin-offs of C-Corp and vice versa denied tax-free treatment under PATH Act
- Could structure as taxable spin depending on gain in assets

POTENTIAL REIT STRUCTURES
SPIN-OFF

Examples:

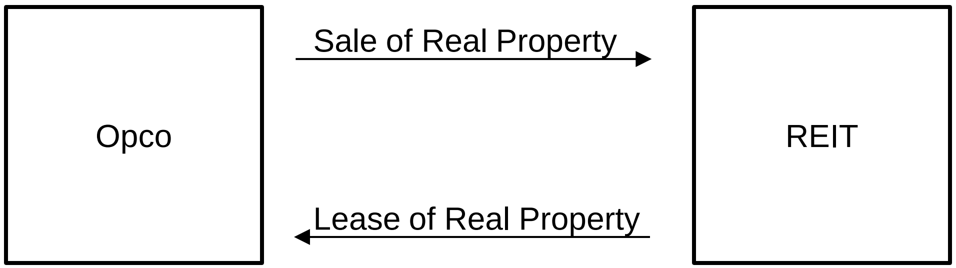
Windstream Holdings (CS&L REIT)

- Windstream spun off CS&L in a tax-free transaction, with CS&L owning its communication distribution systems.
- Distribution systems were triple-net leased back to Windstream Holdings.

Darden Restaurants (Four Corners Property Trust)

- Darden spun-off Four Corners in a tax-free transaction, with Four Corners owning its restaurant properties.
- Four Corners triple-net leased the properties back to Darden to operate.

POTENTIAL REIT STRUCTURES
SALE/LEASEBACK



- Corporation engaged in real estate intensive business sells real property assets to REIT
- Opco leases the real property back from the REIT

POTENTIAL REIT STRUCTURES
SALE/LEASEBACK

<u>Examples:</u>

CorEnergy

- Conducts sale-leasebacks with energy companies and generally triple-net leases the assets back to the seller.
- Preferences:
  - US assets with long remaining economic lives
  - Assets central to partner's operations
  - $50-$500 million investment size
  - 10-20 year lease terms
  - Exit through lease renewal or partner repurchase at FMV
- Completed Transactions:
  - Pinedale Liquid Gathering System
  - Portland Terminal
  - MoGas Interstate Natural Gas Pipeline
  - Grand Isle Gathering System

POTENTIAL REIT STRUCTURES
SALE/LEASEBACK

<u>Examples:</u>

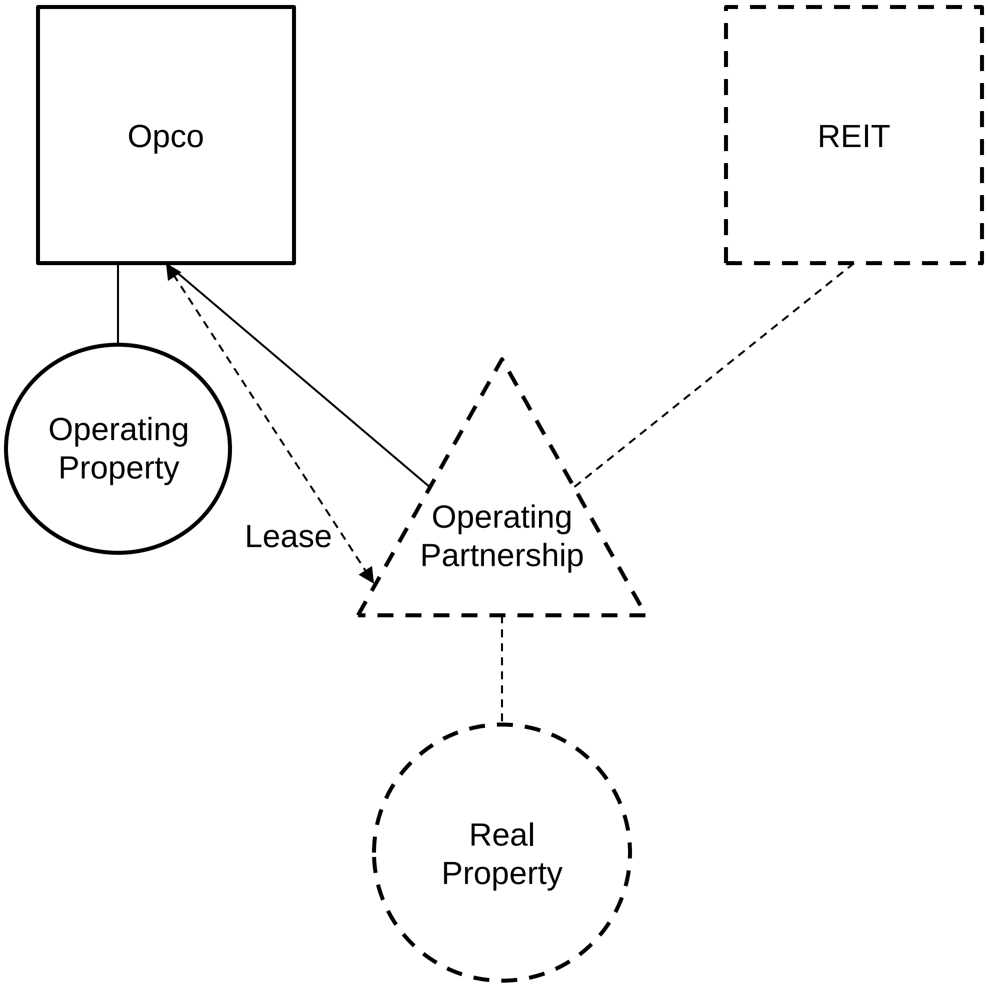
CorEnergy (cont.)

- Benefits of Transactions:
  - Lessee retains complete operational control and majority of upside
  - Realization of proceeds from assets not fully valued by market
  - Positive impact on balance sheet
  - Operator can monetize at its desired pace
  - Access to capital without dilution or increased leverage

National Retail Properties

- Conducts sale-leasebacks with convenience store operators such as Susser and generally triple-net leases the assets back to the seller.

POTENTIAL REIT STRUCTURES
DROPDOWN/CONTRIBUTION



- Opco forms a joint venture with an existing or newly formed REIT
- REIT raises funds from equity offering and contributes cash to operating partnership for interests therein
- Opco contributes real property to the operating partnership joint venture in exchange for interests therein and, potentially, cash
- Operating partnership leases properties to sub of Opco. No partner to partner attribution under related-party rent rules.

POTENTIAL REIT STRUCTURES
DROPDOWN/CONTRIBUTIONS

Examples:

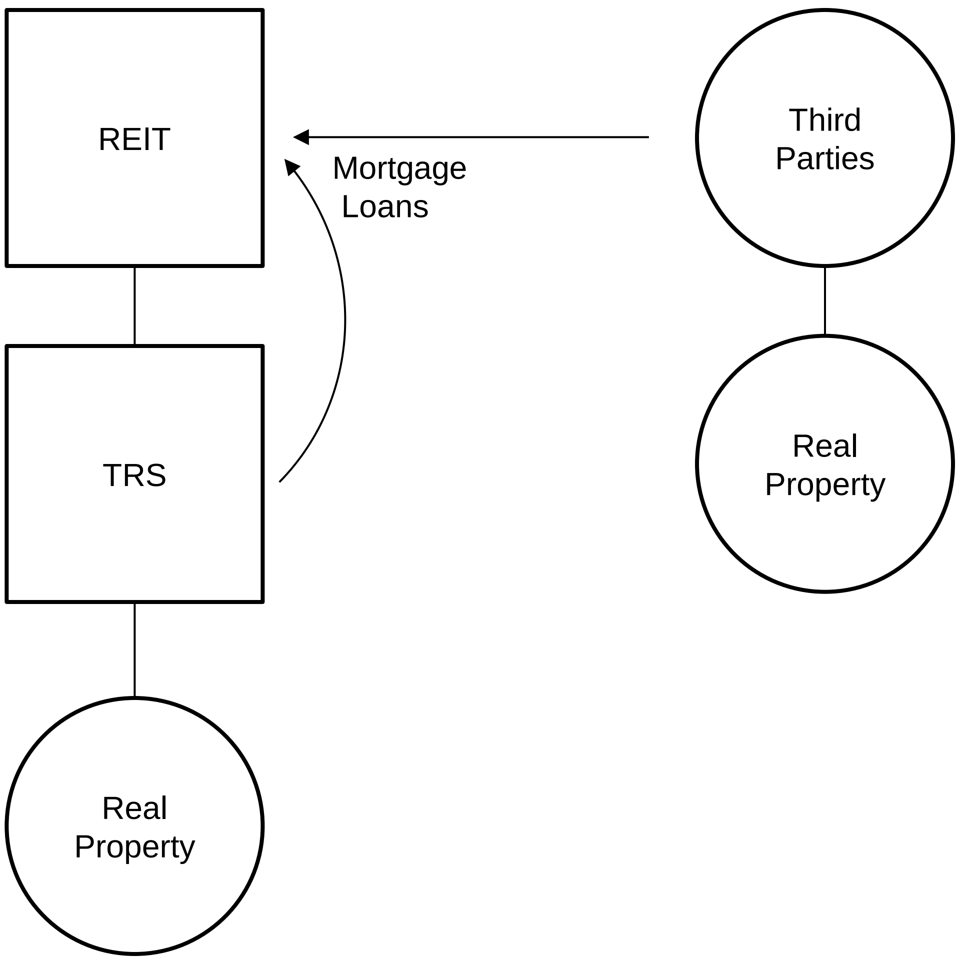
MGM Resorts/MGM Growth Properties

- MGM Resorts contributes property (and associated debt) to operating partnership of newly-formed REIT (MGM Growth Properties) in exchange for OP Units.
- Operating partnership leases casino properties back to subsidiaries of MGM Resorts.
- MGM Growth Properties conducts IPO; pays down assumed debt with combination of IPO proceeds and refinancing.

Hudson Bay/Simon Properties

- Hudson Bay contributes department store properties to newly-formed JV with Simon Properties.
- Simon Properties contributes cash to JV.
- Hudson Bay takes cash distribution from JV.
- JV leases department store properties back to Hudson Bay.

POTENTIAL REIT STRUCTURES
MORTGAGES



- REIT holds real-estate mortgage loans from third parties or, to limited extent, from TRS sub
- This strategy may be executed in conjunction with the other strategies mentioned in this presentation.

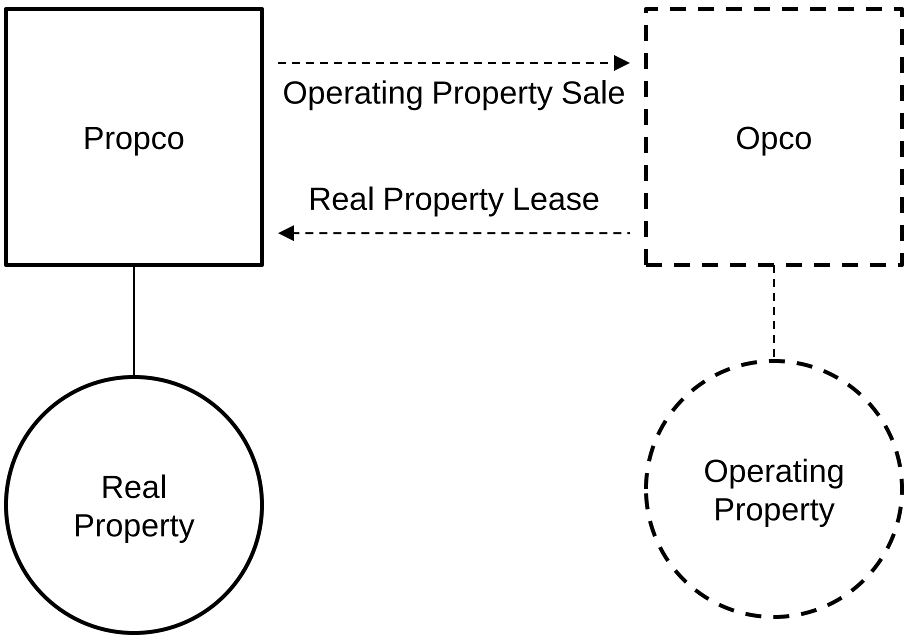
POTENTIAL REIT STRUCTURES
MORTGAGES

Example:

Hannon Armstrong

- Lends on renewable energy and energy efficiency projects.
- Lending on real estate assets done directly by REIT.
- Lending on non-real estate assets done through TRS.

POTENTIAL REIT STRUCTURES
C-CORP CONVERSION



- Corporation with real property intensive business (“Propco”) sells operating property to unrelated party (“Opco”) and Propco leases real property to Opco, who operates the business
- Propco makes a REIT election
- Temporary Regs issued in June 2016 require immediate taxation on built-in gain if C-Corp. was spun-off in tax-free spin in prior 10 years.
- Otherwise, “Sting Tax” period runs for 10 years.

POTENTIAL REIT STRUCTURES
C-CORP CONVERSION

Example:

American Tower

- REIT conversion as of 1/1/12
- In business of leasing space to wireless providers
- Utilized TRSs to continue to operate non-REIT compliance businesses
- E&P Study to ensure C-Corp. E&P had been distributed.

POTENTIAL REIT BENEFITS

WHAT ARE THE POTENTIAL BENEFITS OF REIT UTILIZATION?

- Inexpensive equity financing
- Ability to monetize assets
- Tax efficient for institutional investors
  - Unlike MLPs, REITs are tax-efficient for institutional investors such as tax-exempt organizations, mutual funds and non-U.S. investors
- Potential for recovery of tax allowance for regulated assets
- REIT stockholders receive 1099s instead of K-1s

ENERGY INFRASTRUCTURE REITS
WHO ARE SOME OF THE PLAYERS?

CorEnergy Infrastructure Trust, Inc. (NYSE: CORR)

- Market Cap: Approx. $335m
- Dividend & Yield: $3.00 per sh / Approx. 9.9%
- Assets: Midstream and downstream (pipelines, gathering systems, storage terminals, rail terminals, gas & electric transmission and distribution assets) and loans secured by energy infrastructure.

ENERGY INFRASTRUCTURE REITS
WHO ARE SOME OF THE PLAYERS?

InfraREIT, Inc. (NYSE: HIFR)

- Market Cap: Approx. $760m
- Dividend & Yield: $1.00 per sh / Approx. 5.9%
- Assets: Electricity transmission & distribution assets in Texas

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ENERGY INFRASTRUCTURE REITS
WHO ARE SOME OF THE PLAYERS?

Hannon Armstrong Sustainable Infrastructure Capital, Inc. (NYSE: HASI)

- Market Cap: Approx. $969m
- Dividend & Yield: $1.20 per sh / Approx. 5.83%
- Assets: Loans secured by energy infrastructure and renewable assets.

ENERGY INFRASTRUCTURE REITS
WHO ARE SOME OF THE PLAYERS?

Communication Sales & Leasing, Inc. (Nasdaq: CSAL)

- Spin-off from Windstream Holdings, Inc.
- Market Cap: Approx. $4.4b
- Dividend & Yield: $2.40 per sh / Approx 9.8%
- Assets: Energy efficiency systems in commercial properties and renewable energy projects

THANK YOU

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