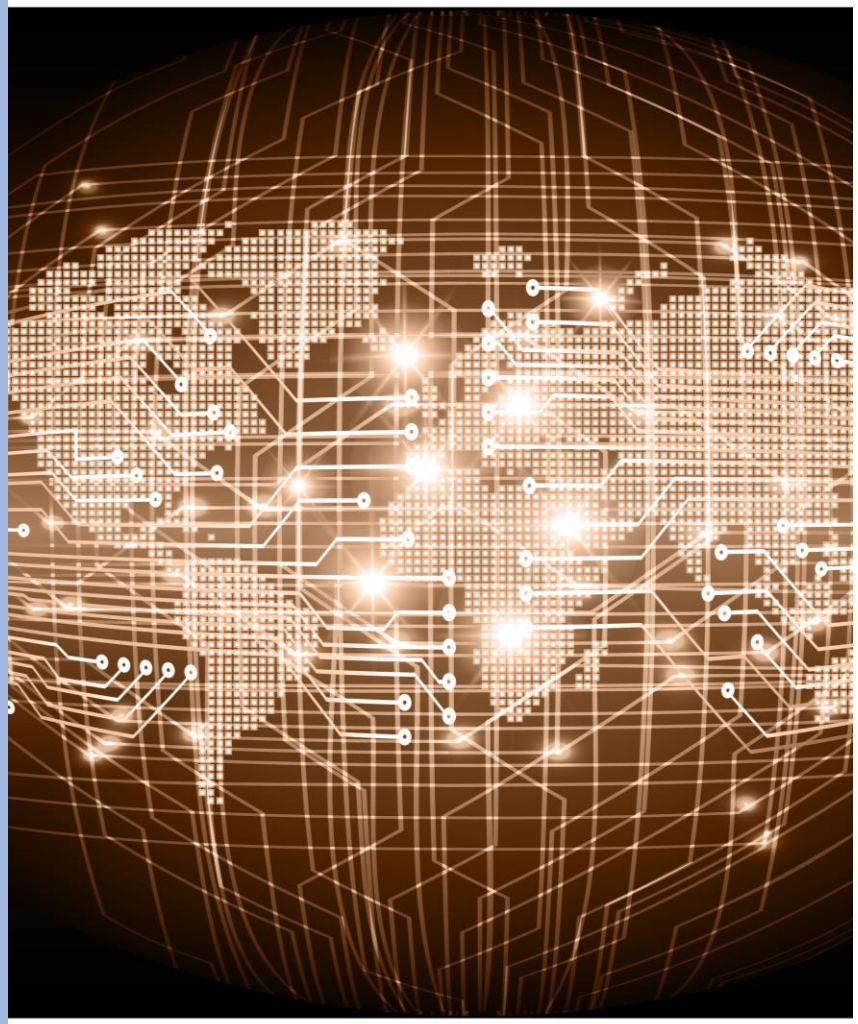
STRUCTURING: KEY CONSIDERATIONS AND OPERATIONAL COMPLEXITIES



Accounting Committee
Wednesday, October 29

Session code: Accounting2

THANK YOU TO THOSE THAT CONTRIBUTED!!

- Steven O'Donnell, Walton St Capital
- Elizabeth Johnson, DWS*
- Megan James, Invesco
- Tiffany Simonsen, Maybern
- David Aizenberg, Maybern*
- Rob Kay, SS&C Technologies*
- Bo Lake, SS&C Technologies*
- Marlon Fortineaux, RSM*
- Rachel Landau, RSM
- Josh Anker, Alter Domus

AGENDA

- Key Structuring Consideration
- Common Inbound Structures – Leveraged US Blocker
  - Intercompany Loans
  - Transfer Pricing Study
  - Waterfall Considerations
- Tax Considerations
- Reporting Considerations
- Q&A

Key Considerations for Structuring Your Alternative Strategy

Achieving a Balanced Approach

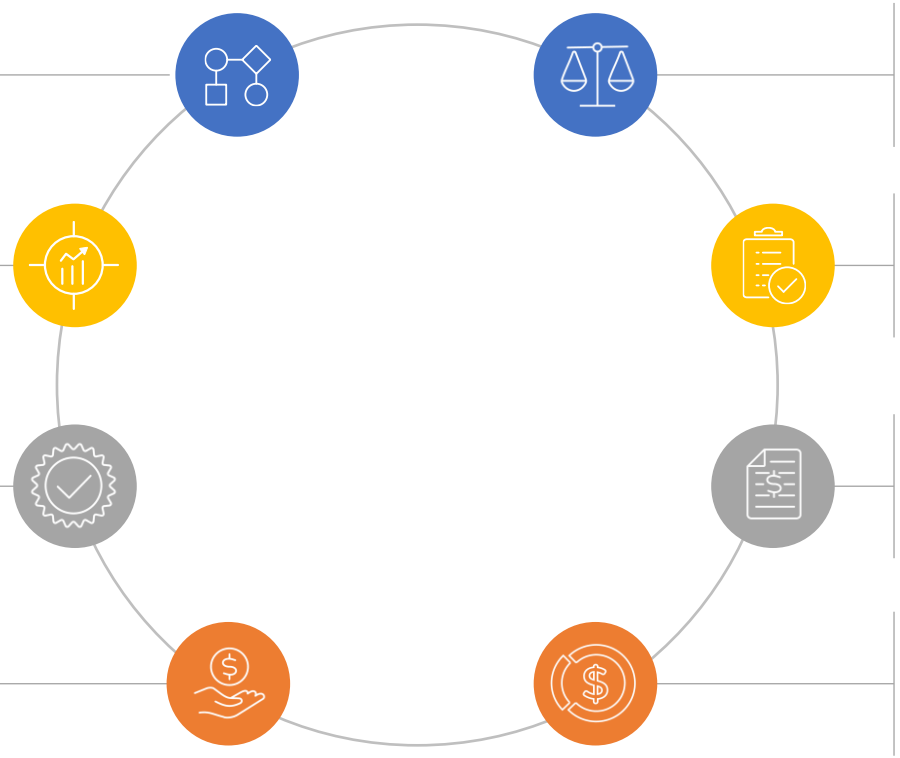
Balancing the interests of the Fund Manager with the investor base to maximize investor returns

Investor Type
Needs of each investor type being marketed to

Setup & Operational Cost
Cost efficient for maximum returns

Regulatory & Reporting Compliance*
Jurisdictional and structure based compliance needs

Fee Structure*
Asset management, performance and other fee considerations



Legal Structure*
Legal entity form, domicile

Management Team
Experience and track record in structure and strategy

Tax Considerations & Implications*
Investor and Fund based tax considerations

Liquidity Requirements
Managing commitments through market volatility

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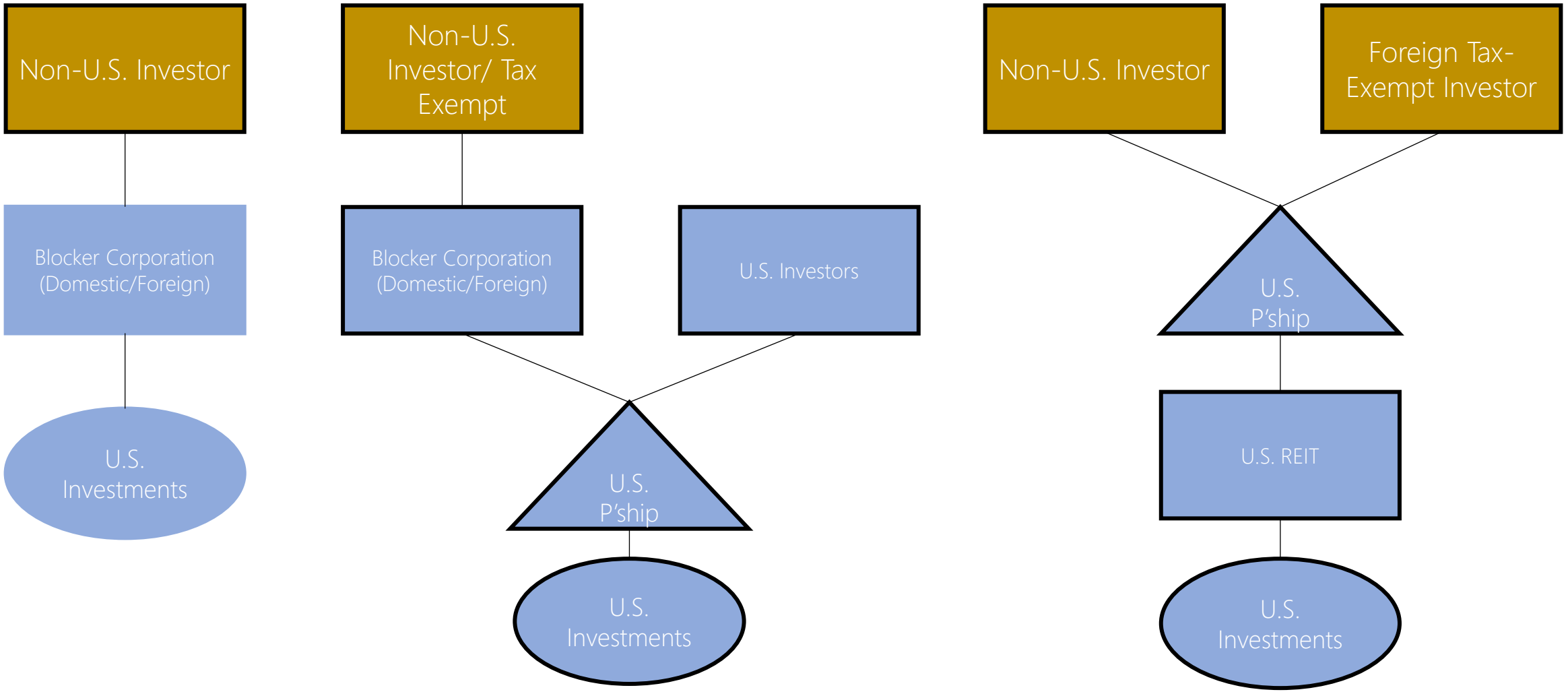
Common Inbound Structures



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Corporate Leveraged U.S. Blocker

Key Characteristics:

- Blocker may be leveraged with debt to reduce U.S. taxable income

Advantages:

- A portion of earnings are paid out in the form of interest or repayment of principal which may be at a lower tax rate

Disadvantages:

- Increased complexity and compliance burden

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Intercompany Loans

Intercompany loans are intended to move money up and down the structure in a tax efficient manner.

- Structures are generally designed for the interest on the intercompany loans to be tax deductible by the borrower
- Lender can be an entity in the structure or an investor
- Borrower would be lower in the structure and generally pays interest expense and takes the expense as a tax deduction

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Transfer Pricing Studies

Transfer pricing studies ("TPS") generally determine how funds are loaned and repaid, alongside fund strategy and broader tax considerations

- TPS would determine a rate and debt / equity ratios to create or maintain
- Interest rates should approximate market rates for similar size / type of debt
- Debt equity ratios again should approximate similarly sized market covenants
- Other options covered in a TPS:
  - Maturity, borrowing limits, interest spread, compounding, index rates, prepayment penalties, subordination, PIK options

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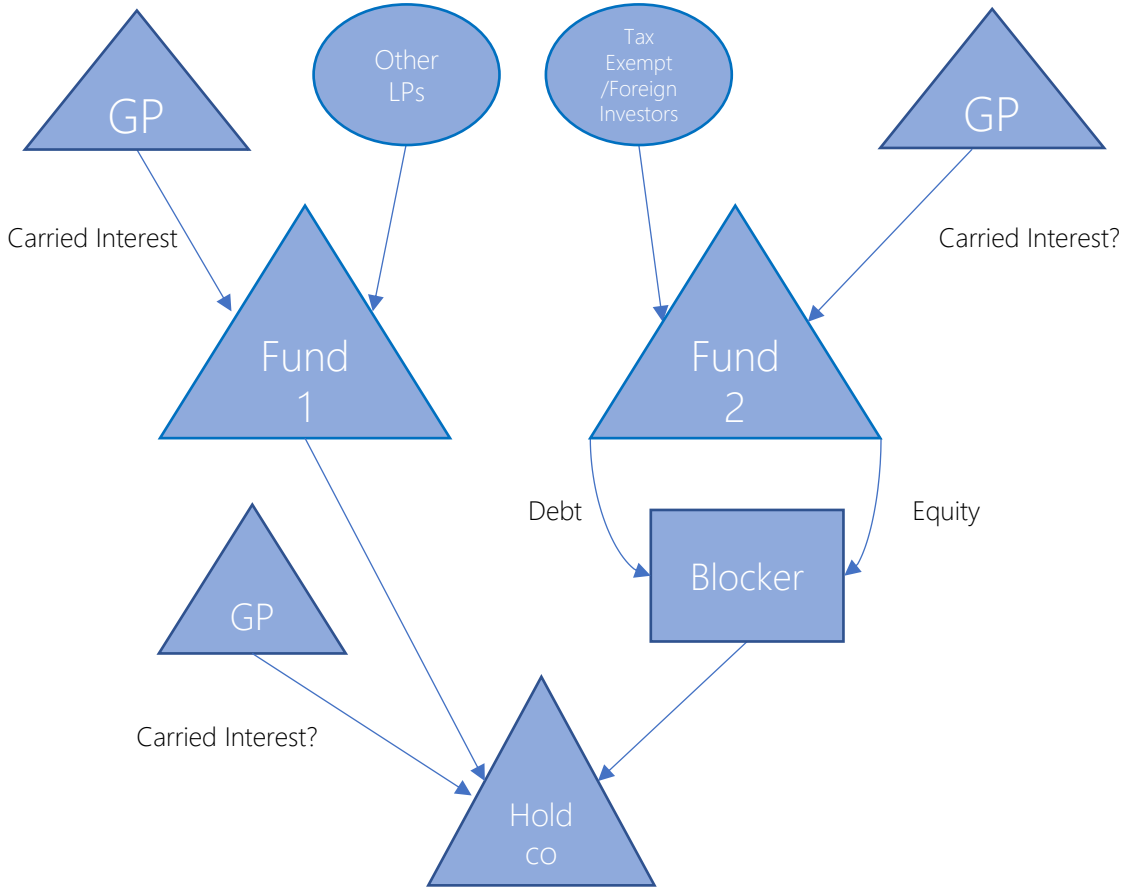
Fund Structure with Blocker – Case Study 1



Fund Facts

- GP and LP contribute capital
- Management Fees might be pushed down in the Blocker fund
- Promote could be paid at multiple levels and require gross-ups
- Management fee still paid, just not illustrated in the example
- Assets below Holdco

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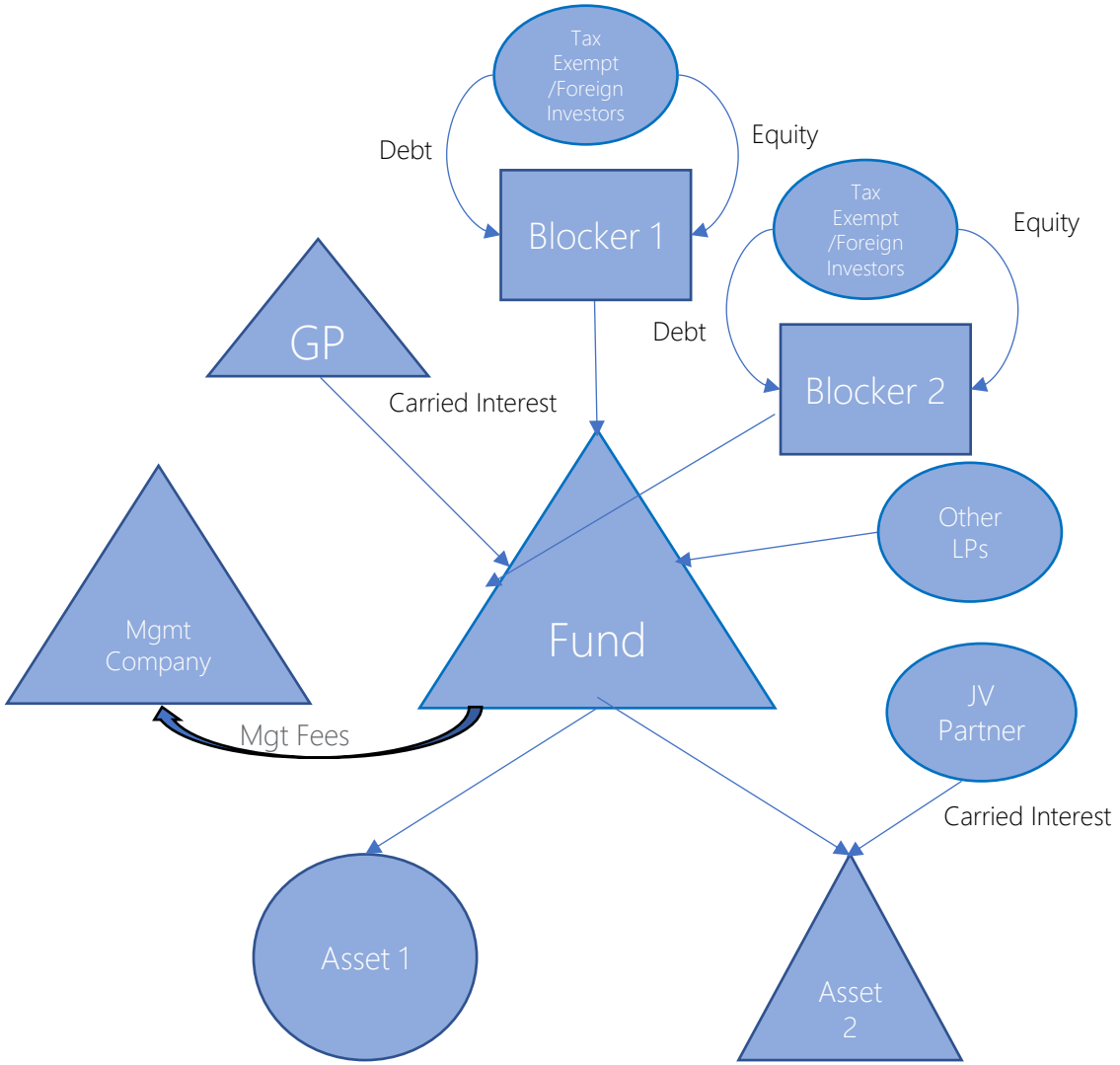
Fund Structure with Blocker – Case Study 2



Fund Facts

- GP, Blocker and LP contribute capital
- Blocker tracks individual deal interests
- Generally, cash from blockers is distributed in a liquidating distribution to shareholders

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Case Study

Year 1

- $1 million of cash on hand
- Loan balance $15 million / accrued interest of $500k
- 70% LTV
- Current E&P of -$50 million

Year 2

- $12 million of cash on hand
- Loan balance of $20 million / accrued interest of $3 million
- 65% LTV
- Current E&P of +30 million, Accumulated E&P of -$20 million

Year 3

- $3 million of cash on hand
- Loan balance of $18 million / accrued interest of $750k
- Current E&P of -$10 million, Accumulated E&P of -$30 million

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Case Study

Scenario

- In Year 1, Blocker 1 incurs significant loss due to underperforming Asset 1
- In Year 2, Blocker 1 receives a large current E&P "pop" towards end of year from sale of Asset 2. Management decides to use $3 million to pay the accrued interest balance. After paying tax estimates and setting aside working capital reserves, management has $6 million of available cash as of December 15th. What should management do with this available cash?
  - Make a principal repayment
    - [this option would result in a lower LTV and thus, not creating an optimal tax efficient vehicle]
  - Transfer available funds to a high yield savings account
    - [this would provide the most favorable economic option for the 15 business days remaining in the calendar year]
  - Distribute to investors in the form of dividend income
    - [a distribution by the Blocker would be treated as dividend income and subject to tax by the non-U.S. investor(s)]
      - If instead the Blocker waited to make the distribution until Year 3, the distribution would first be treated an interest (generally not subject to U.S. income tax)

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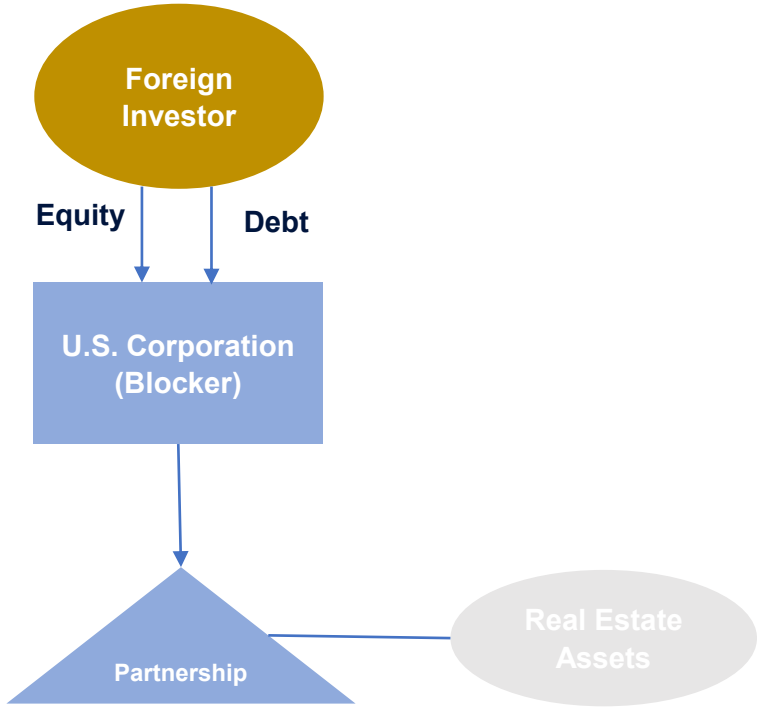
Fund Structure with US Leveraged Blocker – Tax Considerations



- Leveraged blockers help shield foreign and tax-exempt investors from the tax consequences of investing directly in U.S. real estate. This includes avoiding effectively connected income (ECI) and unrelated business taxable income (UBTI), reducing federal and state tax filing requirements, and mitigating or eliminating FIRPTA tax exposure.
- Rental income and gains from property sales (ECI) are recognized by the blocker entity and typically offset by interest deductions, reducing US taxable income with the goal of minimizing tax leakage.
- Payments in the form of interest to foreign investors as interest may potentially be free of US withholding tax for foreign investors (portfolio interest exception or treaty rates).
- Liquidating distributions can be structured as a sale of stock to foreign investors free of US withholding tax under FIRPTA (if USRPHC satisfies cleansing rule).

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Fund Structure with US Leveraged Blocker – Tax Considerations

Tax Issues

- Federal
  - Investor is hit with corporate federal tax leakage
  - Provision might be required
  - Potential 1099 and 1042-S reporting
  - FDAP and FIRPTA withholding on distributions to foreign investors
  - Return of capital subject to withholding without certificates
  - Interest expense limitation without RPTOB election
  - Tax exempt use property
- State
  - Investor is hit with corporate state tax leakage
- Other
  - The leveraged blocker must demonstrate that the loan represents bona fide debt and that the interest rate is at arm's length (transfer pricing study).
  - Promote is paid before blocker expenses and taxes at the fund
  - Cash is held at the blocker until all deal assets are sold before the entity is liquidated

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Blocker Reporting Considerations

- Reporting requirements for Blocker entities can differ depending on:
  - Geographic jurisdiction requirements
  - Level of Blocker in relation to a reporting entity (Blocker between Investor(s) and Fund, Blocker within Fund)
  - Investor specific requirements from agreements and/or side letters.

- Case Study 1: Blocker sits within Fund
  - NAV of investor(s) and GP Promote presented in the Fund report include Blocker expenses
  - Blocker expenses may be allocated directly to investors for which Blocker was created.
  - Blocker can include Deferred Tax Assets or Liabilities
  - Intercompany elimination in consolidation
  - Financial Statement treatment: Consolidation vs. Investment In - diversity in practice

- Case Study 2: Blocker sits between Investor(s) and Fund
  - Additional reporting may be required at the Blocker level

Case Study - Waterfall considerations in blocker structure

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Waterfall Considerations for Corporate Blocker

1. 💧 Context: Why a Blocker Exists

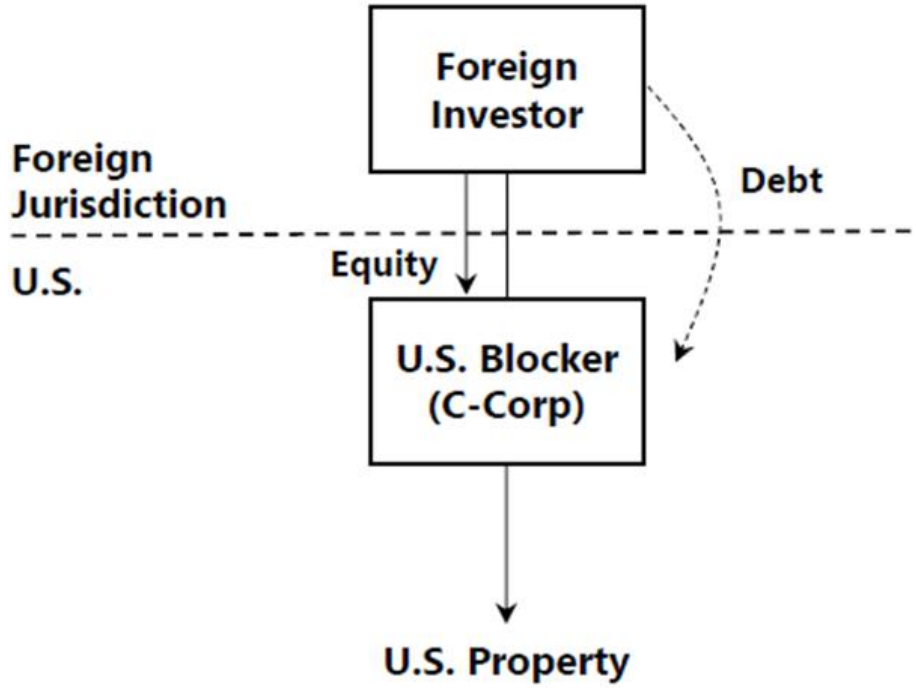
As previously mentioned, a **blocker corporation** exists to shield certain LPs from certain U.S. tax exposures (like UBTI or ECI).
The blocker sits **between the fund and those LPs**, paying entity-level taxes and incurring its own administrative expenses.

2. ⚖️ The Issue for the GP

Those **blocker-level taxes and expenses** can reduce the net distributions flowing to affected LPs.

If the **carry waterfall is calculated after** blocker expenses, the **GP's carry is effectively reduced**, even though the GP doesn't benefit from or control those blocker-level costs.

Generally, LPAs consider this and are explicit that the carry calculations should occur as if those blocker entities do not exist.



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Case Study

Simple Waterfall Example

Contribution Date	1/1/23
Distribution Date	12/31/23
Number of Days	365.00
Preferred Return	8%
Contribution	1,000,000
Distribution	2,300,000
Catch Up Terms	0
Carry Partner Final Split	20%
LP Final Split	80%
Blocker Corp Taxes	250,000
Blocker Expenses	50,000
Investor 1 LPA Default	Blocker Corp Taxes & Expenses are NOT included for Waterfall
Investor 2 Side Letter	Investor Large Institution pays carry after taxes and expenses

Calculate the GP's portion of proceeds due to them in carry reallocations from this cash distribution

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Case Study

Simple Waterfall Results

Contribution Date	1/1/23
Distribution Date	12/31/23
Number of Days	65.00
Preferred Return	8%
Contribution	1,000,000
Distribution	2,300,000
Catch Up Terms	0
Carry Partner Final Split	0%
LP Final Split	80%
Blocker Corp Taxes	250,000
Blocker Expenses	50,000
Investor 1 LPA Default	Blocker Corp Taxes & Expenses are NOT included for Waterfall
Investor 2 Side Letter	Investor Large Institution pays carry after taxes and expenses

	Investor 1	Investor 2
	No impact of taxes & expenses	*Taxes & Expenses reduce carry*
	LPA Standard	Side Letter
Distribution Proceeds	$2,300,000.00	$2,300,000.00
Blocker Corp Taxes	250,000	250,000
Blocker Expenses	50,000	50,000
Amount through the Waterfall	$2,300,000.00	$2,000,000.00
ROC	$1,000,000.00	$1,000,000.00
Remaining	$1,300,000.00	$1,000,000.00
Pref	$80,000.00	$80,000.00
Remaining	$1,220,000.00	$920,000.00
Final Split LP	$976,000.00	$736,000.00
Final Split GP	$244,000.00	$184,000.00
Total Cash to LP	$1,756,000.00	$1,816,000.00
Total Cash to GP	$244,000.00	$184,000.00
Gross IRR	130.53%	130.53%
Net IRR	75.87%	81.90%

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Waterfall Considerations for Corporate Blockers

📊 Key Waterfall / Carry Design Considerations

1. Is Carry Calculated Before or After Blocker Taxes (or both if unique across LPs)?
   Determine whether carried interest is computed **before** or **after** blocker-level taxes.
   1. *Preferred approach for GP:* Calculate carry **at the fund level**, before blocker taxes, so carry reflects pre-blocker economics.
2. Separate Calculations & Transactions:
   1. Maintain a **parallel waterfall** or LP level allocation schedule and carry calculations for blocker LPs to isolate their tax and expense impact.
3. Tax and Expense Allocations
   1. Clearly delineate that **blocker taxes and fees** are **borne solely by the affected LPs**, not shared pro-rata with the GP or other LPs.
   2. Determine whether always tax and expenses or if tax only impact
4. Waterfall Proceeds
   1. Ensure you're using the **"gross-up" adjustments** or **notional capital accounts** to neutralize the effect of the blocker when computing carry.
5. Transparency / Documentation:
   1. The **LPA and side letters** should explicitly define how blocker-level items are treated, but you may also need internal alignment on:
      1. Distribution waterfall
      2. Carried interest base
      3. NAV (typically always net)
      4. IRRs (may calculate both for investors)

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Global Entity Jurisdictions

Cayman

- (Least stringent regulatory reporting requirements)
- Local auditor signoff on financials
- Appointment of AML officer
- Update CIMA with changes to directors or service providers
- Annual fees / filing of economic substance

Jersey & Guernsey

Annual regulatory compliance returns that include:

- Assets under management (AUM)
- Investor profile and concentration
- AML risk levels
- Fund structure and changes

Ireland

- (Most stringent regulatory reporting requirements)
- Required to submit annual return to CBI (Central Bank of Ireland)
- More stringent investor disclosure requirements
- Annual Directors' Compliance Reports
- Annual tax filing submitted to Irish Revenue department
- KIID – Key Investor Information Documents (submit up front and annually)

Luxembourg

- Monthly and quarterly risk reporting (UCITS) – total NAV, investor capital activity, portfolio risk, leverage and liquidity metrics
- More rigorous AML reporting, including annual AML/CFT questionnaire
- Mandatory local auditor sign-off on financials
- Auditor letters, compliance confirmations, etc.

Other common jurisdictions for Private Markets vehicles include:
Australia, Bermuda, Delaware, Mauritius and Singapore

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Common Offshore Reporting Considerations

- FATCA (Foreign Account Tax Compliance Act) – annual United States filing to report all U.S. investors in offshore entity (July 31 deadline)
- AIFMD reporting – for funds marketed in the EU. Requires additional disclosure of funds investment strategy, risk exposure, leverage, liquidity, etc.
- FAR (Fund Annual Return) reporting – filed with CIMA – Cayman Island Monetary Authority – disclosing basic fund information, financial summary, investor counts and locations, strategy, etc. (June 30 deadline)
- GAAP vs IFRS considerations – (e.g. IFRS not required for Cayman, but can be required for Lux, Ireland, etc.)
- Required quarterly board meetings
- Annual reporting to taxing authorities and central banks
- Auditor and Fund Administrator approvals of NAV calculations
- Must prove "substance" for domicile in these locations

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Q&A

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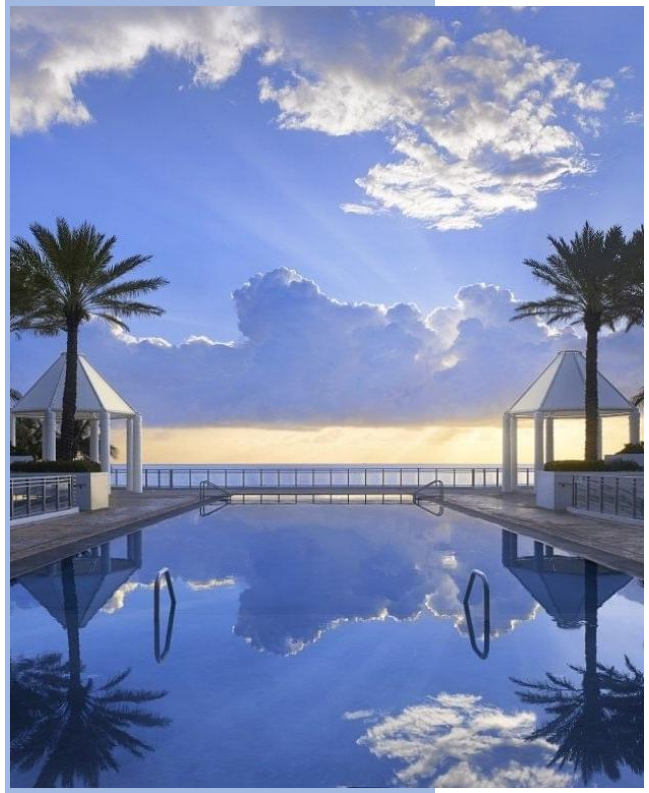
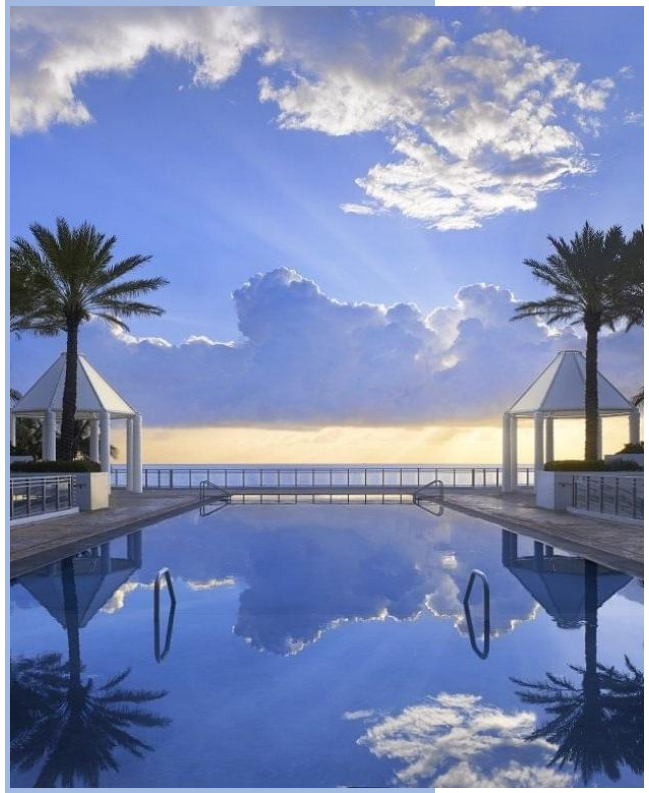


THANK YOU



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