

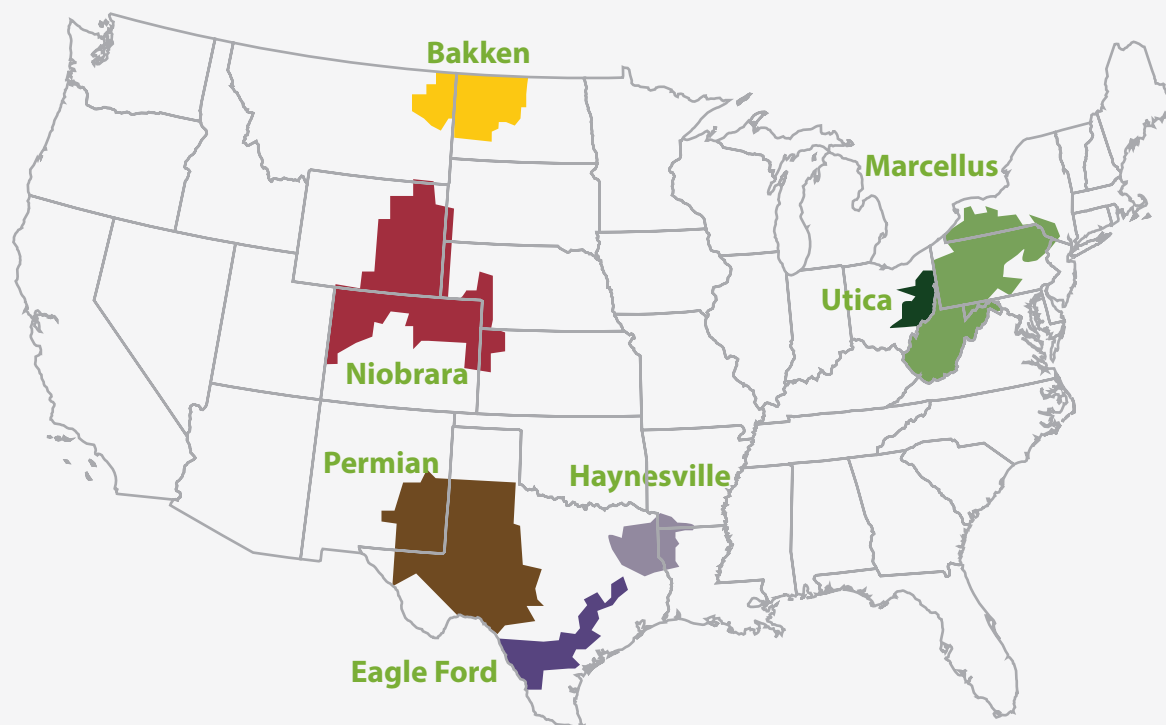
ELMTREE FUNDS UPDATE

SEPTEMBER 2014

The “Carbon Renaissance” and its Effect on CRE

Since 1999, the United States has undergone a significant transformation in energy extraction that will not only extend the timetable to find an economically feasible, sustainable, and renewable energy source, but will also greatly impact the U.S. economy through increased domestic oil and gas production leading to reduced foreign energy dependence. This transformation, known as the “Shale Revolution” or the “Carbon Renaissance”, is the result of a process known

as hydraulic fracturing, or fracking, whereby energy extractors and producers inject hydraulically pressurized liquid into wellbore that breaks rock formations allowing for natural gas, petroleum, and brine extraction. Although fracking has been used since 1947, the technique has only recently become more well-known due to technological advances that have increased economic feasibility.



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(continued)

As shown on the map above, there are seven major shale energy regions in the United States: Utica, Haynesville, Niobrara, Marcellus, Permian, Eagle Ford, and Bakken. The Eagle Ford and the Permian formations run from southeast New Mexico to West Texas and are the highest producing formations. All the formations, aside from

Marcellus, are focused on oil and liquid gas extraction. These seven formations have been highly productive, accounting for 95% of the growth in U.S. domestic oil and 100% of the growth in domestic natural gas production from 2011 to 2013. To illustrate, consider that in 2011 the Eagle Ford and Permian formations combined to produce

approximately 4.8 billion cubic feet of gas per day. As of September 2014, that number has increased to approximately 12.5 billion. Furthermore, U.S. crude oil production is at a 28-year high, with daily production reaching 8.5 million barrels a day in the month of June.

U.S. Field Production of Crude Oil

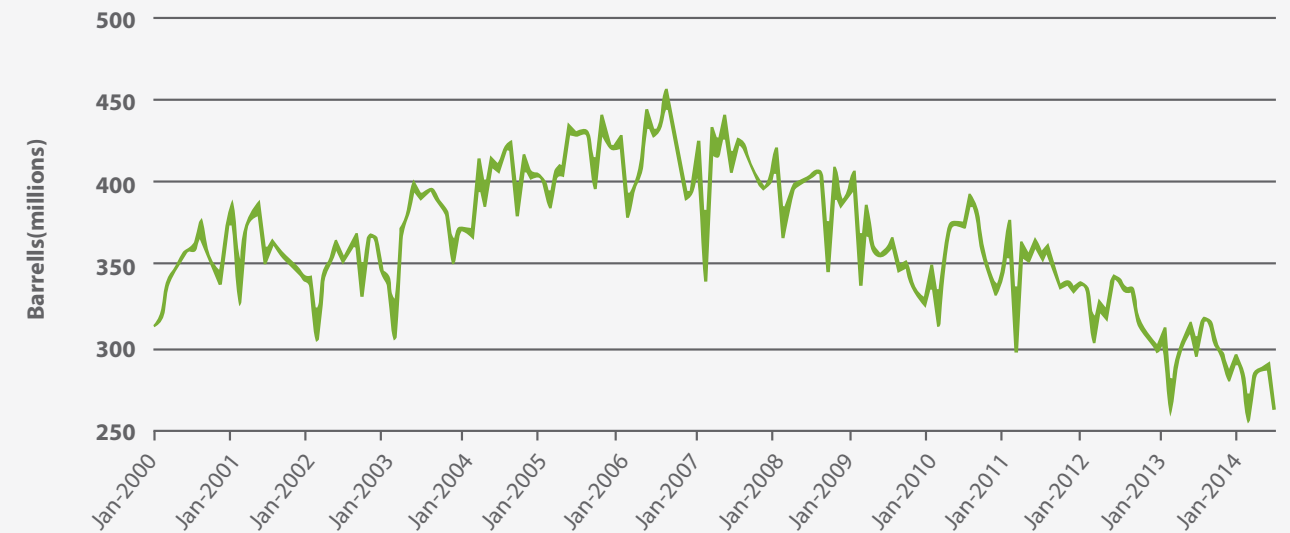


The technological advancements in energy extraction techniques have allowed the U.S. to drastically reduce its energy dependence on foreign countries – a point clearly highlighted

by the chart below. Not only has the U.S. lessened its exposure to energy-rich, and often politically unstable OPEC countries, but also several energy agencies and experts predict that the country will be a net exporter of

natural gas by 2020 and a net exporter of oil by 2030. As the U.S. increases its supply of energy, the cost of that energy for domestic users continues to fall. Up until 2010, domestic and global oil prices were roughly the same.

U.S. Imports of Crude Oil and Petroleum Products



However, since that time, West Texas crude oil is approximately 10%-15% less than the price of Brent oil (oil extracted from the North Seas).

Moreover, the price of natural gas in the U.S. has fallen to roughly one-fourth of the price of natural gas in Japan – a sharp decline from 2007 when the prices were essentially equal. Such

a shift in domestic production and pricing has led to attractive opportunities for various industries.

The “Carbon Renaissance” and its Effect on CRE

(continued)

The energy intensive industries that have benefited from the “Carbon Renaissance” include basic chemicals, iron and steel, fabricated metals, machinery, non-metallic minerals, resins and synthetics, plastics and rubber, agricultural chemicals, and petroleum refining. Even more specifically, the dominant markets for energy intensive industries include Chicago, Houston, Dallas, New York, New Jersey, Los Angeles, Denver, Philadelphia, Louisiana, Pittsburgh, Detroit, and Milwaukee.

Companies and individuals are moving to these cities in order to benefit from the “Carbon Renaissance”, which creates an advantageous, two-pronged effect for real estate investors. First, as companies continue to move their operations, these dominant markets experience population growth, which spurs commercial and residential property demand, increases absorption and rent growth, and improves other real estate fundamentals. Second, incoming capital stimulates the underlying economy which typically improves property performance.

Many of these markets have been experiencing strong returns. Industrial properties in Houston, Harrisburg, and Denver have returned a five-year average of 12.5%, 11.4%, and 10.8%, respectively. Office properties have

also performed well in particular markets, returning a five-year average of 12.2% in New York, 10.2% in Denver, 9.9% in Dallas, 9.5% in Houston, and 8.4% in Los Angeles. Although this trend is good news for property investors, is it sustainable? With advanced fracking technologies in relative infancy, it is reasonable to expect the “Carbon Renaissance” to continue for years to come. Technologies will improve and lead to more efficient energy extraction processes, ultimately increasing domestic production. As a result of increased production, U.S. energy will continue to remain favorably priced, which will attract energy-intensive companies looking to relocate, thereby driving employment, population growth, and commercial and residential real estate demand.



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