



A Primer on Master Limited Partnerships

Pension Consulting Alliance, Inc.

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Master limited partnerships (“MLPs”) have provided investment opportunities since the 1980s. As the infrastructure marketplace continues to develop in the United States and abroad, institutional investors continue to explore the various investment vehicles which comprise the infrastructure landscape. As with all infrastructure opportunities, Pension Consulting Alliance, Inc. (“PCA”) encourages public pension plan investors to be cautious before investing in infrastructure. In addition, PCA encourages public pension plan investors to seek legal advice before investing in MLPs.

I. Introduction to MLPs

A master limited partnership (“MLP”) is a publicly traded company that is structured as a limited partnership rather than a corporation. Limited partnership interests are traded on public exchanges like common stock and primarily focus on the natural resources sector of the economy. MLPs operate capital-intensive businesses that typically generate revenue streams at either fixed (with annual inflation-linked increases) or federally regulated rates. MLP partnerships usually have below-investment-grade credit ratings and they pay out almost all of their distributable cash flow (“DCF”)¹ through quarterly distributions. The partnerships avoid double taxation of corporations, and are instead taxed on a deferred basis.

MLPs consist of a general partner (“GP”) and limited partners (“LPs”). GPs typically hold a 2% ownership and are responsible for managing the operations of the MLP. They are also entitled to incentive distribution rights (“IDRs”) when an MLP reaches certain distribution cash flow targets. As cash flows per LP unit rise through different intervals or tranches, the GP is entitled to an increasing percentage of the incremental cash flows distributed by the partnership (commonly up to 50%). LPs provide capital to MLPs and are the unitholders of publicly traded partnership interests. They do not take part in managing the partnership. LPs benefit from quarterly cash flow distributions and capital appreciation of MLP partnership interests. Historically, MLP distribution yields have generated 6-7%. Further, over the past twenty years, capital growth has totaled 4%-8% annually².

II. Evolution of MLPs

The MLP structure was created in 1981. Originally, MLPs operated in a variety of cyclical and often volatile industries. These included exploration and production of oil and natural gas, restaurants, sports teams and other consumer activities. In the late 1980s, MLPs evolved into entities that generally owned midstream assets used to transport, process and store natural gas, crude oil and refined petroleum products. These partnerships had limited exposure to commodity price risk and primarily consisted of mature assets that generated stable cash flows for their unitholders.

¹ DCF = Recurring Net Income + DD&A + Other Non-Cash Items / Adjustments to Reserves – Maintenance Capital Expenditures.

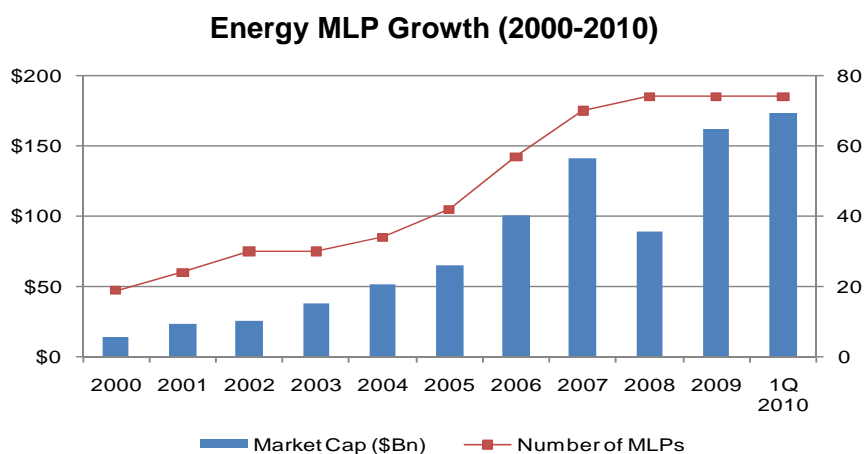
² Wachovia Capital Markets, LLC, “MLP Primer – Third Edition,” 2008.

The MLP structure was redefined through the *Tax Reform Act of 1986* and the *Revenue Act of 1987*. The legislation stated that the established structure would apply to limited partnerships only if at least 90% of their revenues came from natural resource activities, real estate, commodity investments and specific capital gains and losses related to the above sectors. Natural resource activities include exploration, development, mining or production, processing, refining, transportation, storage and marketing of any mineral or natural resource.

MLPs continued to evolve, adding various types of assets to the qualified structure. Refined products pipeline assets were introduced in 1986 and refining, and oil and gas reserves, which were originally introduced in the 1980s, were re-introduced in 2006. In the late 1990s, due to ample market availability of midstream assets, MLPs started to focus on growth, executing acquisitions and initiating expansion projects. MLPs in the plastics and fertilizer industry did not survive due to the cyclical nature of their businesses.

Since 1986, energy-related MLP assets have transformed from structures operating stable pipeline businesses to more volatile commodity-sensitive businesses. MLPs formed in the late 1980s and early 1990s generally owned fee-based limited commodity exposure pipeline and storage assets. Currently, MLPs own a wide variety of assets across energy and other commodities; various degrees of commodity price sensitivity exist within modern structures. Examples of existing MLP assets include onshore and offshore pipelines that transport natural gas, crude oil, refined products and ammonia, gathering and processing operations, fractionation facilities, storage assets, marketing businesses, propane distribution, natural gas, oil and coal production, liquid natural gas and waterborne transportation.

Today, most existing MLPs are positioned in the energy markets. Approximately 90 MLPs exist in the marketplace with energy and natural resource MLPs dominating the sector. Since 2000, the number of energy MLPs has more than tripled (to 74) and their market capitalization has soared 1,100% to approximately \$174 billion. They currently account for about 80% of all publicly traded MLPs, up from 37% in 1990³.

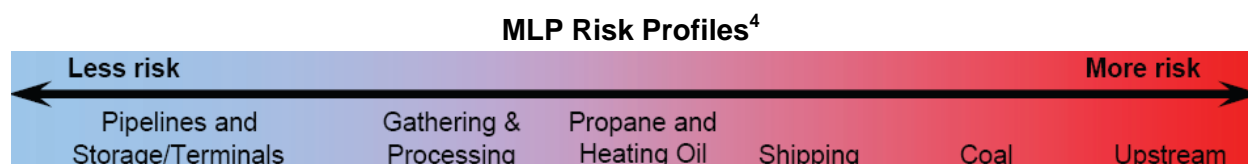


³ Legg Mason Global Asset Management, "Master Limited Partnerships: An Introduction", 2010.



III. Types of Assets in Energy MLPs

The energy MLP universe is comprised of various asset types. The impact of commodity prices on cash flows depends on the type of asset class the MLP operates in.



The types of assets in energy MLPs include the following:

Midstream

Midstream MLPs are involved in the gathering and processing, transportation and/or storage of crude oil, natural gas, natural gas liquids (NGL) and/or refined petroleum products. Midstream MLPs generally have stable, fee-based cash flows with low volatility. The Federal Energy Regulatory Commission (“FERC”) regulates tariffs and allowed rates for interstate natural gas pipelines. The FERC also regulates crude oil and refined products pipelines (e.g. gasoline, diesel, jet fuel, distillates). Pipeline and storage asset MLPs are generally not directly affected by high commodity prices. Pipeline earnings depend on fixed capacity payments; however, high commodity prices may have an indirect impact on pipeline volume with decreasing user demand.

Propane and Heating Oil

Propane MLPs distribute propane via truck to residential, commercial, industrial and agricultural customers. Propane distribution cash flows are based on cost plus a margin. Therefore, changes in propane costs can affect MLP revenues. Propane prices fluctuate based on winter heating demand, oil price trends and chemical demand. Because the majority of revenues are generated during the winter heating season, the business is seasonal.

Shipping

Shipping MLPs transport energy products primarily via tankers or barges. The primary customers include large oil refiners, chemical producers, integrated oil & gas companies and energy marketing companies. Shipping services are usually performed under spot and term contracts through a competitive bidding process. The rates charged under these contracts are either calculated on a daily basis or on a volume transported basis. Most MLP contracts are long-term in nature, providing cash flow stability to the partnerships. Shipping MLPs can be considered to be higher-risk investments versus pipeline MLPs due to more stringent regulatory requirements, shorter-term contracts versus pipeline MLPs, spot market volatility, competitiveness of the contract bidding process, new build risk and a decline in demand for shipped products. Like pipeline MLPs, shipping MLPs do not have direct exposure to commodity prices. However, revenues may be impacted by decreased demand in times of high commodity price environment.

⁴ Wachovia Capital Markets, LLC, “MLP Primer – Third Edition,” 2008.

Coal

Coal MLPs consist of coal producers and coal royalty businesses that own, lease and manage coal reserves. The royalty partnerships enter into long-term leases, providing coal operators the right to mine coal reserves in exchange for royalty payments. Royalty payments depend on the amount of coal produced and its sale price. Risks related to coal MLPs include declining coal prices, operational and geological issues, regulatory issues (specifically environmental) and reliance on lessees to operate and produce coal reserves. MLPs with coal assets directly benefit from high commodity prices. Coal MLPs own coal reserves and either lease their reserves in return for royalty payments or mine the reserves directly. Because most coal is sold under 1-3 year contracts, higher prices don't immediately affect sales prices.

Upstream

Upstream MLPs are focused on the exploitation, development and acquisition of oil and natural gas producing properties. These partnerships produce oil and natural gas, selling products to third parties. Upstream MLPs generally own and operate assets in mature basins; they typically do not participate in exploratory drilling. Risks associated with upstream MLPs include declining commodity prices, inability to hedge at attractive prices and a lack of acquisition opportunities. Most partnerships mitigate commodity price risk through hedging 70%-90% of production for 1-3 years.

Refining

Refining MLPs produce specialty and fuel products from the refining of crude oil. These products include lubricating oils, solvents and waxes that are used for industrial, consumer and automotive products. Risks related to refining MLPs include rising feedstock prices (i.e. crude oil), changing demand for refined products, development of alternative/competing products and unscheduled refinery turnarounds.

Compression

Compression MLPs provide natural gas contract compression services. Natural gas compressors are used to compress a volume of natural gas to facilitate delivery of the gas from one point to another. Risks associated with compression MLPs include a decline in drilling activity and the inability to pass rising operating costs to customers. These partnerships have limited sensitivity to commodity price fluctuation.

Liquefied Natural Gas ("LNG")

LNG is the process during which natural gas is transformed from a gaseous to liquid state and shipped via marine tankers to consuming markets. After delivery, the LNG is returned to its gaseous state. Significant declines in natural gas prices would negatively affect LNG MLPs.

General Partner Interests

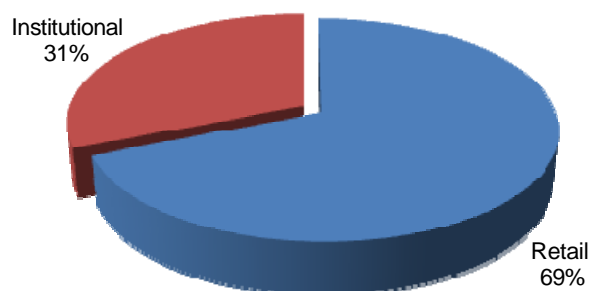
The general partner interests marketplace consists of 11 publicly traded general partnerships; 10 of these are structured as MLPs. The partnerships are structured as corporate shells and hold the general partnership interest and IDRs of the underlying MLP. Some general partnerships also own LP units of the underlying MLP. The partnership receives cash payments

from the MLP and re-distributes these payments (minus expenses) to unitholders. Investments in these securities are leveraged plays on the underlying MLP as the general partnership's performance and distributions depend on the underlying MLP's operations and distributions. The IDRs entitle the general partnership to receive a disproportionate amount of cash flow from the underlying MLP as it raises distributions to LPs. Risks associated with general partner interests include potential challenges at the underlying MLPs.

IV. Market Participants

Although institutional ownership of MLPs has increased over the years, retail investors have traditionally been holders of the majority of outstanding MLP interests. MLP distributions are typically subject to the Unrelated Business Taxable Income ("UBTI") rules, which generally make MLPs unsuitable investments in tax deferred retirement accounts. As of 2008, approximately 69% of total MLP units outstanding were held by retail investors, with 31% held by institutions⁵.

Retail and Institutional Ownership of MLPs

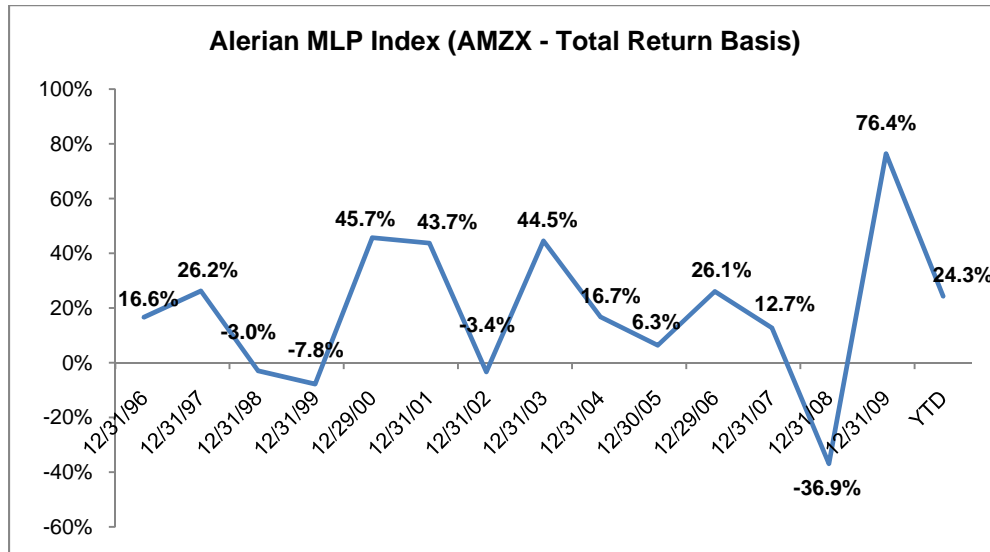


Because they are publicly traded securities, MLPs are subject to the Securities and Exchange Commission ("SEC") and Sarbanes-Oxley Act reporting, record keeping and disclosure requirements. They are also required to issue an annual K-1 tax return to unitholders. In the mid-2000s, a number of closed-end funds focusing on MLP investments were created, offering diversification and allowing investors to avoid filing K-1s for individual MLPs. Hedge funds also began to participate in the MLP marketplace as it expanded. Further, institutional investor ownership has grown with the growth of the asset class.

⁵ Wachovia Capital Markets, LLC, "MLP Primer – Third Edition," 2008.

V. Historical Performance

Historical performance of MLPs has been relatively strong as compared to other assets. The exception occurred between 2007 and 2008, when the asset class went through a sharp sell-off totaling (41.1%), peak-to-trough. In 2008, MLPs suffered significant losses similar to the public equity markets as MLP indices such as the Alerian MLP Index and the Citi MLP Index had total returns of (36.9%) and (36.8%), respectively. The S&P 500 had total return of (37.0%) during this time period.



Investors were concerned with MLPs' ability to access necessary capital during the credit crunch. However, since 2008, because the assets typically did not face severe credit problems, the investment environment for MLPs has once again become favorable. Market liquidity and a rebound in MLP IPO activity have brought strength to the sector in 2010.

The table below portrays historical MLP performance in comparison to U.S. equities and fixed income. It has outperformed both asset classes over the 3-year, 5-year and 10-year investment periods ending on June 30, 2010. Additionally, historical correlations between the three asset classes demonstrate that MLPs have provided diversification to investment portfolios. As mentioned previously, MLPs have evolved to include assets that are more sensitive to commodity price risk than in the past. With the evolution of the asset class, MLPs now exhibit greater volatility in comparison to stocks.

Comparison of Asset Class Returns and Risks⁶

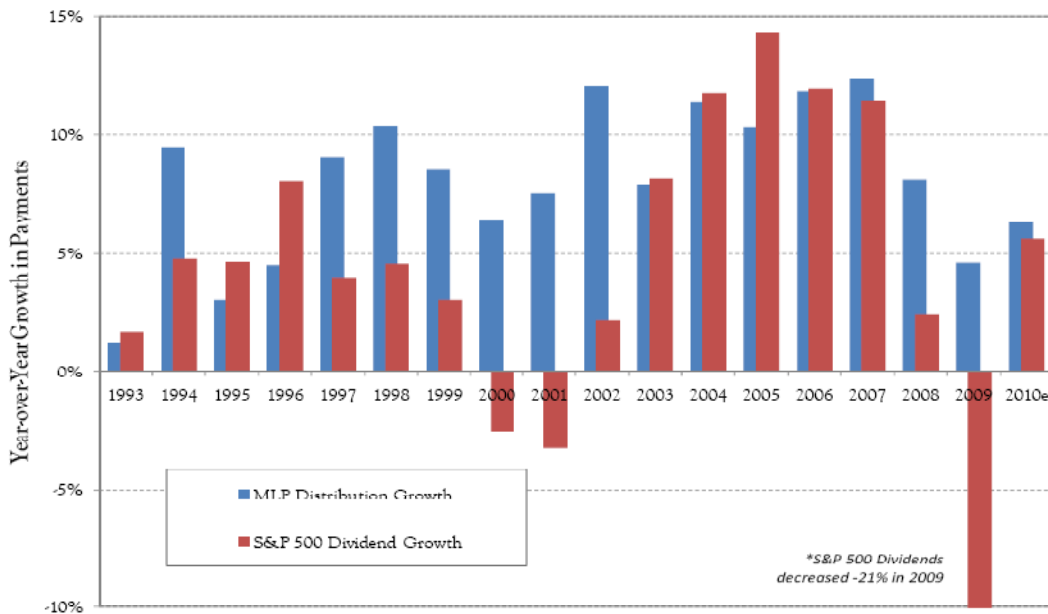
(Periods Ending June 30, 2010)

	Annualized Total Returns			Annual Volatility*	Correlations*	
	3 Years	5 Years	10 Years		To Stocks	To Bonds
MLPs	5.10%	11.20%	18.50%	17.10%	0.39	0.01
U.S. Equities	(9.80%)	(0.80%)	(1.60%)	16.20%	1.00	(0.07)
U.S. Fixed Income	7.60%	5.50%	6.50%	3.80%	(0.70)	1.00

* For 10 year period ended June 30, 2010

The major attraction to the MLP marketplace has been the growth in cash distributions over time. Despite the economic and market turmoil of the last few years, gross distributions on MLPs have grown at a 7.9% annualized rate across the most recent 10 years. However, the short-term growth of MLP distributions is forecast to slow to a 3%-4% annual rate due to a lower growth in the volume of resources transported as well as lower inflation-based annual rate increases.⁷

Annual Growth Rate: MLP Distributions vs. U.S. Equity Dividends⁸



⁶ Mill Creek Capital Advisors, LLC, "Alternative Asset Classes: Master Limited Partnerships (MLPs)," 2010.

⁷ Mill Creek Capital Advisors, LLC, "Alternative Asset Classes: Master Limited Partnerships (MLPs)," 2010.

⁸ Mill Creek Capital Advisors, LLC, "Alternative Asset Classes: Master Limited Partnerships (MLPs)," 2010.



VI. Performance Drivers

Distribution Growth and Distribution Yield

Distribution yields and their growth serve as an essential driver of MLP performance. MLPs typically pay out a large proportion of their excess cash flows through quarterly distributions to unitholders. The distribution yield is inversely related to expected distribution growth because investors are willing to forego current yield in return for future distribution growth.

Capital Costs and Access

The success of MLP partnerships depends on their ability to effectively manage projects as well as execute profitable acquisitions. Limited access to financing would negatively impact MLPs that require significant capital resources to continue producing strong returns.

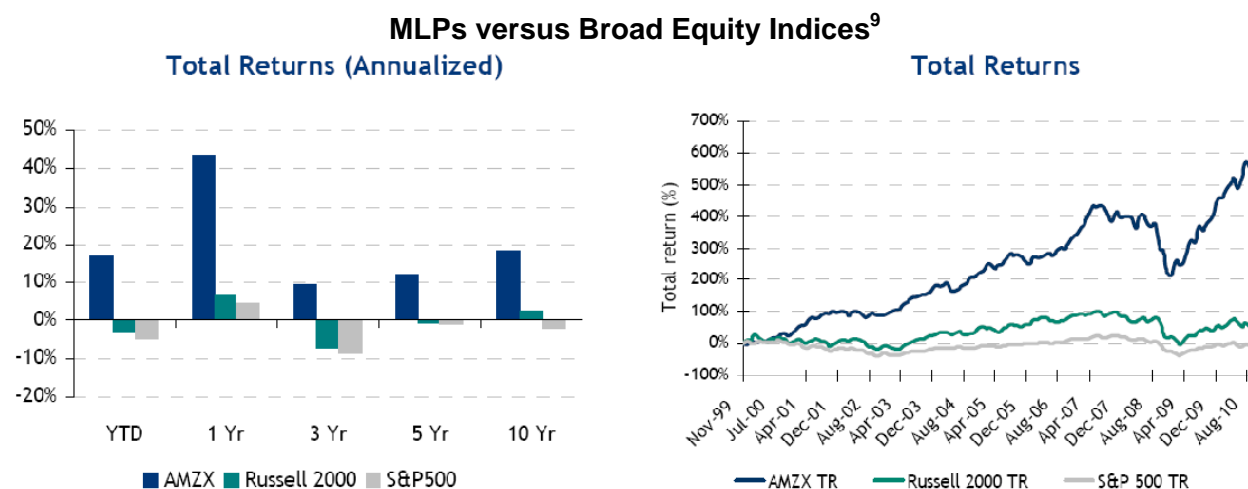
Interest Rates

Investors often invest in MLPs because of the current yield the securities offer. Such yields are compared to government bond yields. Therefore, as government bond yields fall, MLP prices rise.

VII. Investment Merits

Strong Relative Performance

MLPs have generated strong relative returns over the last decade. MLPs, as represented by the Alerian MLP Index (“AMZX”) in the graph below, have outperformed the S&P 500 and Russell 2000 over the past 10 years.

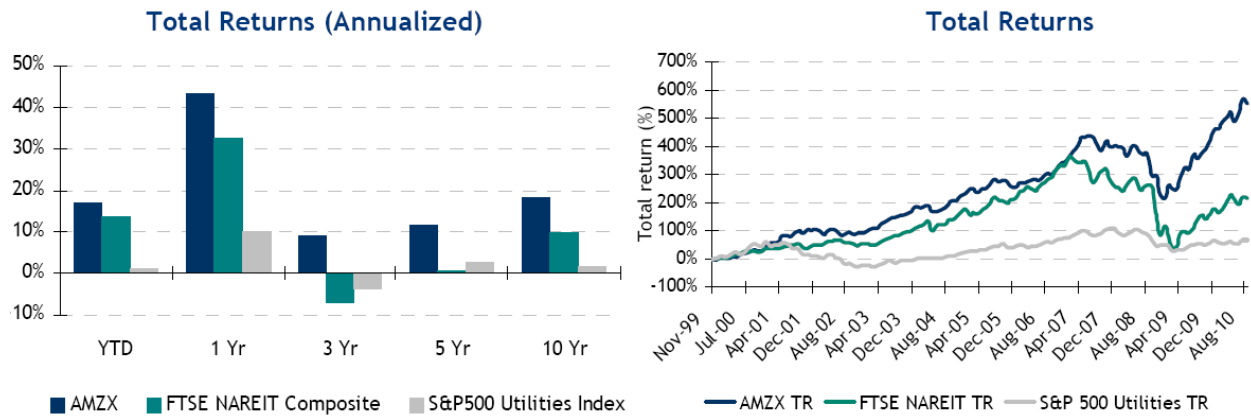


MLPs have also generated strong performance versus other income-oriented equity securities, outperforming the FTSE NAREIT Composite and S&P 500 Utilities Index over the past 10 years.

⁹ Factset, BofA Merrill Lynch analysis. Total returns as of the close, August 31, 2010.

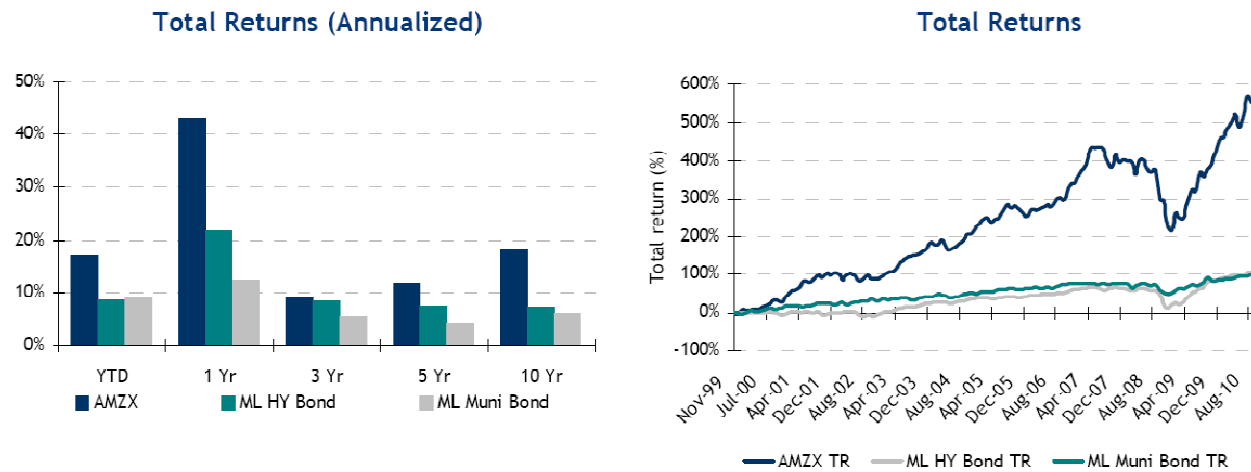


MLPs versus Other High-Yield Securities¹⁰



In addition, MLPs exhibit outperformance versus bond indices, outperforming both the BofA Merrill Lynch High Yield Bond and Muni Bond Index over the past 10 years.

MLPs versus Bond Indices¹¹



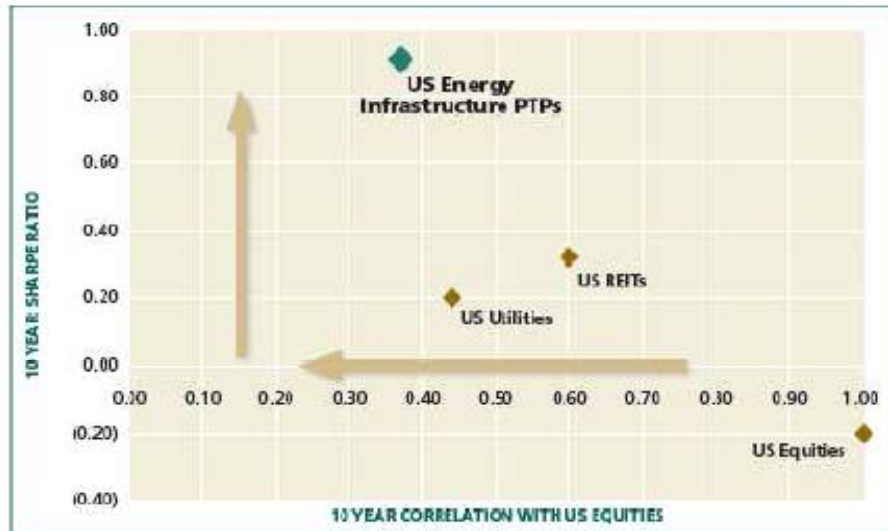
High Risk-Adjusted Returns

Over the last 10 years, the MLP sector has provided investors with high risk-adjusted returns. The chart below portrays U.S. Energy Infrastructure publicly traded partnerships (“PTPs”) in comparison with U.S. Utilities, U.S. REITS and U.S. Equities. It is evident that the 10-year Sharpe ratio¹² of the U.S. Energy Infrastructure assets is significantly higher than that of the other assets shown.

¹⁰ Factset, BofA Merrill Lynch analysis. Total returns as of the close, 31 August 2010.

¹¹ Factset, BofA Merrill Lynch analysis. Pre-tax total returns as of the close, August 31, 2010. ML Muni Bond Index has a duration of 14.6 years and an average rating of Aa2.

¹² The Sharpe ratio is a measure of excess return per unit of risk.



Source: Tortoise Capital Advisors; Oppenheimer & Co.

Stable and Predictable Cash Flows

MLPs pay out almost all of their distributable cash flow. MLPs typically distribute cash flows to unitholders on a quarterly basis, providing investors with a current yield. Because most MLPs generate revenue through fee-based contracts on long-lived assets, cash flows from these investments result in stable and predictable distributions. Further, many MLPs are regulated by the FERC, which establishes ceilings on allowed returns. Although regulation limits the upside in performance potential of MLPs, it also contributes to the stability of the cash flow stream.

Tax Efficient Structure

MLPs are tax efficient instruments. MLPs enjoy the tax benefits of limited partnerships in that they avoid double taxation of corporations. MLPs are only taxed once at the unitholder level, increasing investor yield. Elimination of double taxation also lowers an MLP's cost of capital, supporting higher valuation of assets in the MLP structure than in a conventional corporate structure. Lower costs of capital give MLP projects and acquisitions the potential to be more accretive. Additionally, distributions to unitholders are substantially tax deferred. Investors typically receive a tax shield equivalent to 80-90% of cash distributions received in a given year. The tax-deferred portion of the distribution is not taxable until the unitholder sells the security.

High Barriers to Entry

Most MLP assets operate similar to monopolies. Because the majority of MLP activity is extremely capital intensive (i.e. exploration, development, mining or production, processing, refining, transportation and storage of natural resources), high barriers of entry exist for new market players.

Hedge against Inflation

MLP cash flows typically grow over time, providing a hedge against inflation. MLPs can grow in three ways: (1) volume and margin growth on existing assets; (2) organic growth projects that add new assets; (3) acquisitions. According to Oppenheimer's MLP monitor, MLP distribution growth has outpaced inflation for each of the past 10 years.

VIII. Investment Concerns

Commodity Price Risk

Although cash flow distributions of many MLPs have limited exposure to commodity prices, commodity price risk still exists in this sector. Although pipeline and storage assets are generally operated through long-term fee-based contracts, certain MLP assets can be negatively impacted due to volatile energy prices and volume sensitivity, weakening cash flow distributions. For example, direct commodity price risk exists in natural gas gathering and processing MLPs. Indirect commodity sensitivity may be caused by declining drilling activity. Further, crude oil and refined products pipelines are volume sensitive.

Increased Correlation to Other Asset Classes

Historically, MLPs have been marketed as valuable diversification tools for investors' portfolios, exhibiting low correlation to other asset classes. However, during the most recent financial crisis, correlation between the Alerian MLP Index and various asset classes increased significantly and has remained higher than normal. The chart below portrays changes in correlation between the Alerian MLP Index and various asset classes.

Correlation of Alerian MLP Index Relative to Various Asset Classes

	S&P500	Natural Gas	Crude Oil	10-Yr Treasury	Utilities	REITs	BarCap HY	Moody's Baa	Russell 2000
2001	0.37	0.06	0.78	0.15	0.09	-0.20	0.47	0.07	0.33
2002	0.34	0.35	0.27	-0.01	0.59	0.11	0.61	0.03	0.36
2003	0.55	0.20	-0.18	-0.15	0.37	0.14	0.67	-0.24	0.31
2004	0.24	0.05	0.01	-0.25	0.62	0.65	0.50	-0.70	0.43
2005	0.03	-0.11	0.14	-0.53	0.52	0.21	0.41	-0.51	0.12
2006	0.39	0.47	0.37	-0.35	0.55	0.38	0.59	-0.24	0.43
2007	0.29	0.45	0.32	0.25	0.33	0.13	0.19	0.16	0.36
2008	0.44	0.12	0.40	0.30	0.18	0.26	0.45	0.01	0.41
2009	0.21	-0.01	-0.16	-0.01	0.32	0.21	0.72	0.01	0.23
YTD	0.56	-0.36	0.89	0.03	0.66	0.43	0.77	0.86	0.43
1-Year	0.57	0.13	0.46	0.06	0.62	0.29	0.70	0.24	0.52
2-Year	0.46	0.11	0.47	-0.01	0.40	0.32	0.66	-0.16	0.41
5-Year	0.46	0.11	0.37	0.02	0.38	0.31	0.62	-0.15	0.42
10-Year	0.39	0.12	0.20	0.06	0.38	0.30	0.59	-0.18	0.40

Note: 1, 2, 5 and 10-year correlations as of June 30th, 2010

Source: FactSet

Limited Liquidity

Liquidity in the MLP sector has historically been thin. According to Bank of America Merrill Lynch, the 1-year average daily volume (“ADV”) for a typical MLP is approximately 486,000 shares. An investor in the sector would be unable to move in and out of positions quickly, making liquidity a potential issue, especially in times of financial stress.

Potential Unrelated Business Taxable Income (UBTI) Complications

Investment in MLPs may have unwanted tax consequences for tax-exempt investment vehicles (i.e. pension accounts, 401-Ks, IRAs, pension and endowment funds) because they may generate UBTI if it is determined that MLP income is considered income earned from business activities unrelated to the entity’s tax-exempt purpose. The general rule states that if a tax exempt entity receives UBTI in excess of \$1,000 per year, the investor would be required to file IRS form 990-T and may be liable for tax on the UBTI. Public pension plan investors should seek legal advice before investing in MLPs.

General Partner Incentive Distribution Rights

General partners are entitled to IDRs within the MLP distribution structure. As cash flows per limited partner unit rise through different intervals or tranches, the general partner is entitled to an increasing percentage of the incremental cash flows distributed by the partnership (commonly up to 50%). Although IDRs benefit limited partners in that they incentivize the general partner to grow cash distributions to unitholders, they also negatively impact investors. As the percentage of distributions allocated to the general partner increases, the partnership’s cost of equity also rises over time, making it more difficult to increase cash distributions.

For example, a general partner has a 2% ownership interest in the MLP. As the general partner’s payout increases to a level equal up to 50% of distributions, its ownership stake generally does not increase. Therefore, the general partner is responsible for funding 2% of the capital required but receives 50% of the incremental distribution paid.

Possibility of Increased Energy Infrastructure Regulation

Much political spotlight has been cast on oil and gas companies in the recent months. Many industry participants expect increased energy regulation to be put in place as a result of two recent oil spills, including the most recent BP Gulf of Mexico oil spill. There is currently much uncertainty in the energy marketplace, especially around the future offshore drilling. Potential future regulation may have a negative effect on energy infrastructure assets run by MLPs.

Interest Rate Risk

MLPs may be affected by a significant rise in interest rates. First, increased interest rates can increase the costs of debt, making organic growth projects and potential acquisitions more expensive and less accretive. Further, rising interest rates can increase opportunity costs for income seeking investors, thus potentially putting downward pressure on MLP valuations.

Possible Significant Change in MLP Tax Code

In their current form, MLPs avoid double taxation of corporations through their limited partnership structures. However, potential future changes in U.S. tax code may weigh on attractive MLP yields. Because the U.S. government is currently facing significant budget deficits, changes to the tax code may be one way to increase revenues. While most market participants believe that the probability of such an event is relatively low given the importance of energy infrastructure to the U.S. economy, it is a risk nonetheless.

FERC Regulatory Risk

FERC regulates the interstate transmission of electricity, natural gas and oil. The agency also sets tariffs within the marketplace. Increased FERC regulation may lower profitability that MLPs currently offer investors.