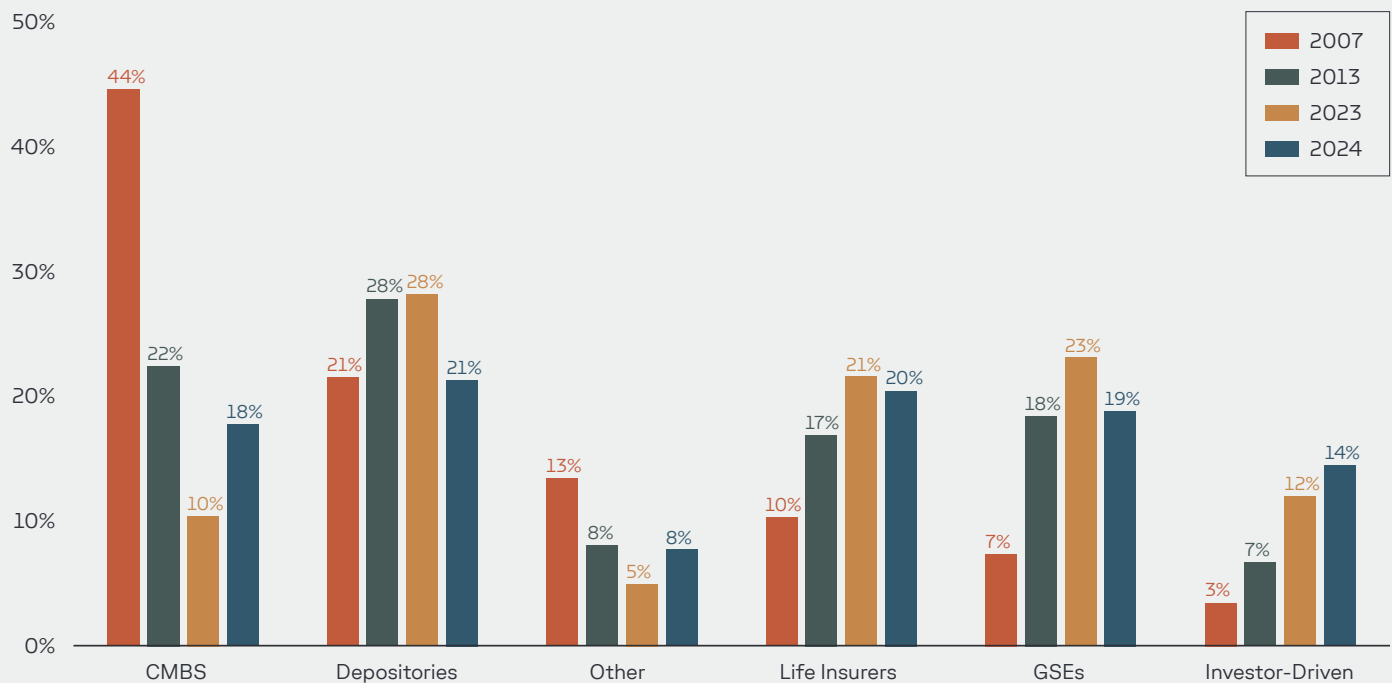



The commercial real estate lending market continues to undergo a major shift. **Traditional lenders, especially banks, have pulled back due to a combination of regulatory pressures, legacy issues, and economic uncertainty.**

This dynamic began as a result of market and regulatory dynamics post-GFC, and has accelerated in recent years. As shown in the exhibit, this has enabled debt funds, along with life insurers and the GSEs, to increase market share substantially.

U.S. SHARE OF LOAN ORIGINATIONS BY LENDER TYPE



Source: MBA Loan Origination Survey

As discussed in our recent **RESEARCH PAPER**,  several factors have altered the landscape and caused some banks to lend to private funds rather than directly to borrowers, including:

- Regulatory Capital Efficiency:** Changes to Risk-Based Capital (RBC) rules since the GFC have led to higher capital requirements for banks, especially for loans considered "High Volatility Commercial Real Estate (HVCRE)". HVCRE loans, which often finance acquisition, development, or construction of commercial real estate, carry risk weights of 150% or more. This means banks need to hold more capital against these loans, reducing their profitability. In contrast, loans to non-bank lenders, like private debt funds, have lower risk weights, often 50% or less if the fund has a good credit rating. This can make it more capital-efficient and profitable for banks to lend to funds rather than directly to CRE projects, especially riskier ones.
- Asset Management Expertise:** If a bank balance sheet loan goes bad, they may lack the specialized asset management skills needed to effectively manage the distressed property. Private debt funds, on the other hand, often have expertise in managing and working out distressed real estate assets.
- Regulatory Scrutiny:** Banks face significant regulatory scrutiny, and a high rate of loan defaults can trigger even more oversight and potentially higher capital requirements. Lending to a well-established private debt fund with a strong track record can help banks avoid this added monitoring.

Reduced competition has enabled private credit to continue to offer **COMPELLING RISK-ADJUSTED RETURNS IN TODAY'S MARKET**, particularly for investors seeking refuge from the valuation volatility of recent years. This asset class offers diverse strategies that cater to varying risk appetites while filling critical gaps in the capital markets:

- **Core First Mortgage Lending:** Current market dynamics, including the elevated rate environment and some existing lenders moving to the sidelines, are creating opportunities to originate lower leverage mortgages with attractive coupon rates and spreads. These loans have exhibited compelling attributes over the last 20 years, with strong relative value, risk-adjusted returns, and low correlations versus other asset types.
- **Gap Capital:** Lender retrenchment in recent years has lowered LTVs available from many senior lenders; combined with reduced valuations in the current environment, this is offering attractive detachment points for gap capital strategies, offering equity-like yields but with the benefits of subordination.
- **Construction Lending:** The sharp decline in bank construction lending—negative in 2024 for the first time since the GFC—has created a vacuum for private credit to step in. Investors with flexible capital are well-positioned to take advantage of favorable terms in construction, much of which will deliver in a lower-supply competition environment.



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