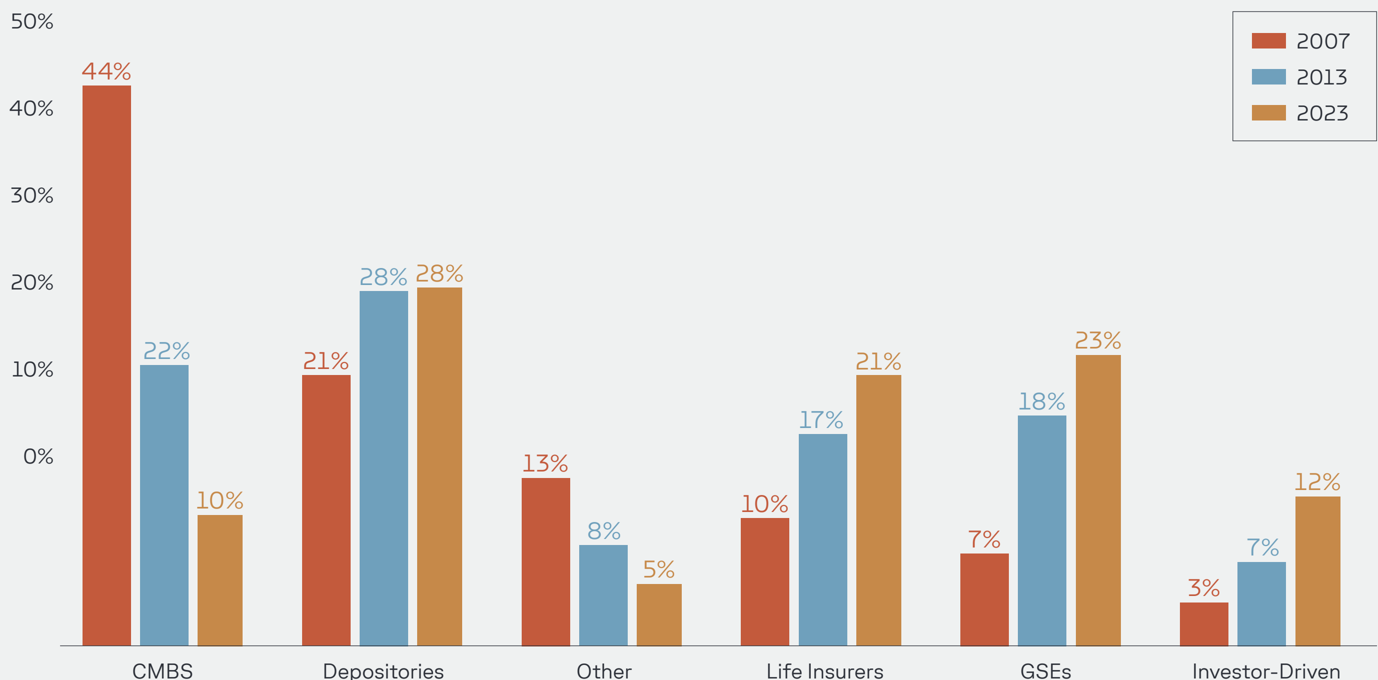
AFFINIUS CAPITAL

REAL ESTATE LENDING

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 YTD 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.

MARK FITZGERALD, CFA, CAIA

Head of North American Research

mark.fitzgerald
@affiniuscapital.com

WILL MCINTOSH, PH.D

Global Head of Research

will.mcintosh
@affiniuscapital.com

Important Disclosures

Affinius Capital® is the brand that applies to it and its advisory subsidiaries including Affinius Capital Advisors LLC and Affinius Capital Management LLC. The information contained in this report is being provided to you by Affinius Capital (together with its affiliates, "Affinius") for information purposes only and is not, and may not, be relied on in any manner as, legal, tax or investment advice. The information contained herein does not constitute an offer to sell or a solicitation of an offer to buy an interest in any investment vehicle sponsored by Affinius and any such offer will only be made pursuant to a confidential private placement memorandum and/or the Partnership's subscription documents, which will be furnished to qualified investors in connection with such offering and will be subject to the terms and conditions contained therein. The information in this report is only as current as the date indicated, and may be superseded by subsequent market events or for other reasons. Affinius Capital assumes no obligation to update the information herein. Investment in a Partnership will involve significant risks, including risk of loss of the entire investment.

Investments and Market Risk. Investments involve significant risks, including risk of loss of the entire investment. Prospective investors should consult their own legal, tax and financial advisors as to the consequences of an investment. Leveraged investments may present additional risks to the investor, including, capital structure risk. Dependence on key personnel may result in operational risk. An investment sponsored by Affinius Capital is intended to be a long-term investment.

Third-Party Data. Certain information contained in this report has been obtained from published and non-published sources. Recipients should understand that any such information may not have been independently verified. Except where otherwise indicated herein, the information provided herein is based on matters as they exist as of the date of preparation and not as of any future date and will not be updated or otherwise revised to reflect information that subsequently becomes available, or circumstances existing or changes occurring after the date hereof.

The opinions and recommendations herein do not take into account the individual circumstances or objectives of any investor and are not intended as recommendations of particular investments or strategies to particular investors. No determination has been made regarding the suitability of any investments or strategies for particular investors. Portions of this report may reflect our opinions and beliefs regarding general market activity and potential impacts of current market conditions. Such opinions and beliefs are subjective, do not represent a complete assessment of the market and cannot be independently verified.

9830 Colonnade Blvd., Suite 600
San Antonio, Texas 78230 USA

affiniuscapital.com