APRIL 2025 | INVESTMENT RESEARCH

The Expanding Opportunity for Private U.S. Real Estate Credit

Executive Summary

While uncertainty continues to challenge sentiment and activity, the stability and resilience of private real estate credit can provide a reliable income stream with built-in downside protection.

- At $4.8 trillion the U.S. private CRE credit market is an asset class comparable in size to major fixed income markets, offering a robust foundation for diversified investment.
- Private CRE credit enhances portfolio returns by providing predictable income streams and downside protection, while maintaining low correlation to other major asset classes, minimizing additional risk.
- Normalizing interest rates drive high current income while a recovering real estate market strengthens credit fundamentals, boosting the potential for solid returns on new investments while reducing risk.
- Increased need for debt capital, driven by loan maturities, building modernization needs and selective bank appetite, creates opportunities for alternative and flexible financing solutions.
- A growing range of property types, including operational assets, provides an expanded universe of investment opportunities, allowing for greater diversification and higher value-creation potential.

Five Key Themes Supporting Private Credit Investing Today

1	2	3	4	5
A $4.8 Trillion Asset Class	**Portfolio Enhancing Features**	**Improved Risk-Return Profile**	**Need for Debt Capital**	**Expanding Opportunity Set**
A growing market, comparable to major fixed income markets in size	Enhancing portfolio returns without introducing additional risk	Capitalizing on normalizing interest rates and a real estate market recovery	Addressing maturity, modernization and bank regulatory uncertainty	Growing universe of property types drive diverse opportunities

For Professional and Institutional Investors only. All investments involve risk, including the possible loss of capital.

Why Private CRE Credit Makes Sense Now

Private commercial real estate (CRE) credit has outpaced both real estate equity and traditional fixed income in total returns over the past decade, a period marked by a significant reset in property values.

While CRE credit has historically outperformed traditional fixed income, the recent downturn in real estate has contributed to its outperformance relative to equity (**Exhibit 1**). With risk-free rates now higher than in the previous cycle, real estate credit is expected to continue performing well.

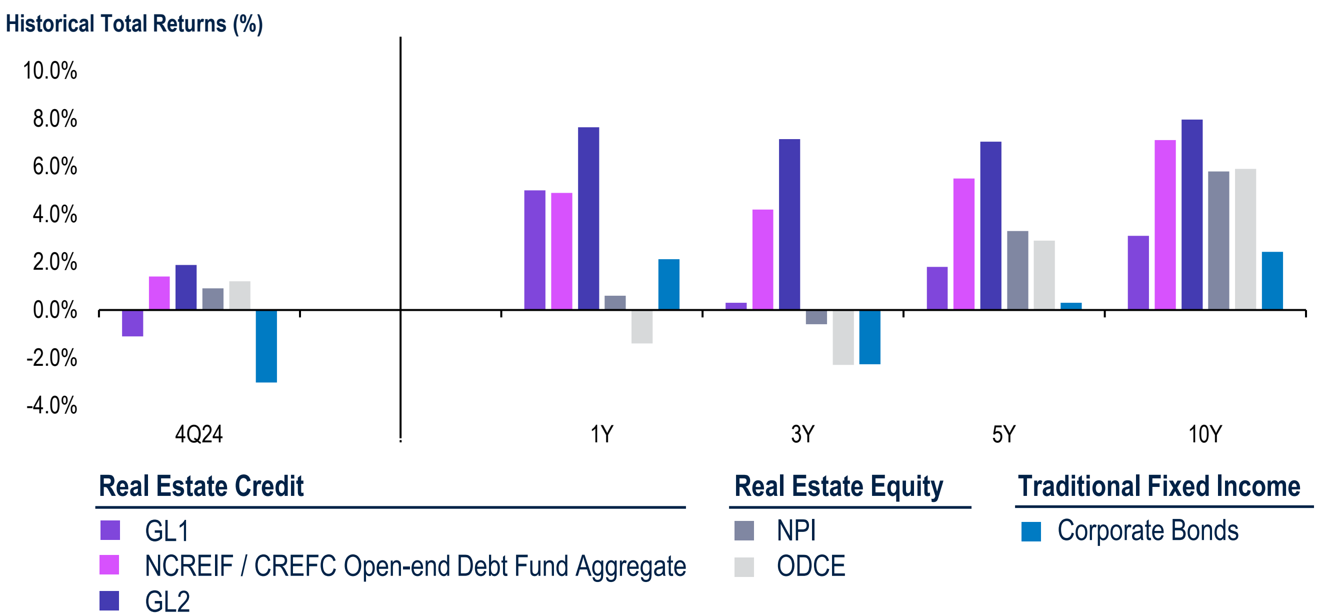
With a focus on income-driven approaches offering downside protection and capital preservation, real estate credit provides a predictable income stream with lower volatility compared to real estate equity and traditional fixed income.[1]

As the market continues to face uncertainty, we are reminded of the stability and resilience of private real estate credit, and the downside protection it brings.

Moreover, the current market environment, characterized by elevated but moderating interest rates, offers a solid income stream. Conservative attachment points also provide significant equity cushions, enhancing principal protection.[2]

As the real estate market approaches recovery, a specific segment of the private real estate credit market warrants closer attention: financing for value-add business plans. This strategy primarily utilizes floating rate loans, which mitigates interest rate risk, while strategic leverage can boost returns without adding property or credit risk.[3] This segment benefits from increased demand for shorter-term loans as borrowers anticipate future rate cuts.

Exhibit 1: Real Estate Credit Has Outperformed Real Estate Equity and Traditional Fixed Income Over the Last Decade



The GL1 is a fixed-rate, fixed-term senior loan held by institutional lenders like life insurance companies and pension funds. The NCREIF/CREFC Open-End Debt Fund Aggregate is an equal-weighted composite of fund-level returns from open-ended CRE debt funds with strategies ranging from core to value-add and including both fixed- and floating-rate loans. GL2 represents high-yield CRE debt, such as second mortgages, mezzanine loans, and preferred equity. The NPI reflects unlevered core CRE equity, primarily in residential, office, industrial, and retail sectors. ODCE represents levered, capitalization-weighted, gross-of-fee returns from open-ended core equity CRE funds that use low-leverage strategies. The Bloomberg US Corporate Bond Index tracks the investment-grade, fixed-rate, taxable corporate bond market, including USD-denominated securities issued by U.S. and non-U.S. industrial, utility, and financial issuers.

Sources: Giliberto-Levy, NCREIF, Bloomberg, PGIM Real Estate. As of April 2025.

[1] PGIM Real Estate, *Private Real Estate Debt: A Portfolio Risk-Return Enhance Through the Lens of Maximum Drawdowns*, August 2023.
[2] PGIM Real Estate, *Private Credit Insights*, March 2025.
[3] PGIM Real Estate, *The Strategic Use of Leverage in Real Estate Debt Funds*, January 2024.

1 A $4.8 Trillion Asset Class

An asset class comparable to major fixed income markets

- The U.S. private CRE credit market, valued at $4.8 trillion,[4] represents a substantial asset class on par with major fixed income markets (**Exhibit 2**).
- This depth allows for a diverse array of loan structures, with varying durations and secured by a broad range of property types across multiple locations. The diverse credit profiles of the underlying tenancy further enhance the market's diversification potential.
- Despite its private nature, the private CRE credit market offers significant breadth, providing investors with ample opportunities to strategically allocate capital to assets that align with their investment goals and risk profiles.

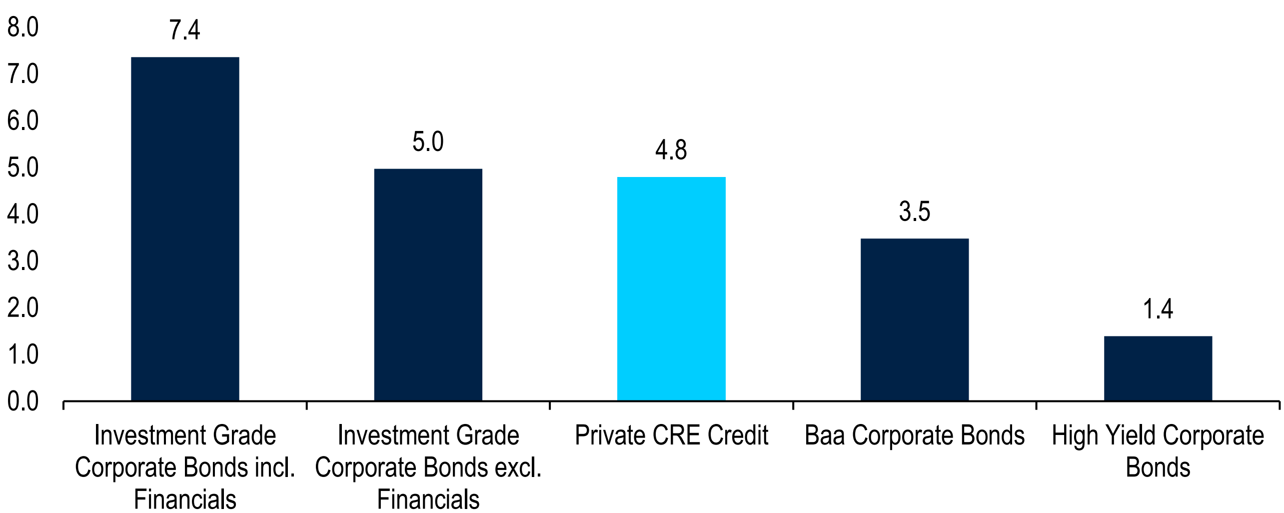
2 Portfolio Enhancing Features

Private CRE credit can enhance portfolio returns without introducing additional risk

- Private CRE credit has outperformed major fixed income asset classes while exhibiting lower volatility.[5] This combination has delivered Sharpe ratios nearly twice those of other fixed income indices, positioning it as an attractive choice for optimizing portfolio risk-adjusted returns.[6]
- With correlations of less than 100% to traditional fixed income investments, private CRE credit provides diversification benefits to fixed income portfolios.[7]
- From a risk management standpoint, private CRE credit has exhibited less severe and shorter-lived maximum drawdowns compared to other fixed income assets, helping to limit portfolio losses during periods of financial market turmoil and drawdowns.[8]

Exhibit 2: Private CRE Credit Market Comparable to Major Fixed Income Markets

Debt Outstanding ($ Trillion)



Private CRE Credit refers to Commercial and Multifamily Mortgage Debt Outstanding.
Sources: Bloomberg, Mortgage Bankers Association, PGIM Real Estate. Data as of 4Q24.

[4] Mortgage Bankers Association, Commercial and Multifamily Mortgage Debt Outstanding, March 2025.
[5] PREA Quarterly, How CRE Debt Can Boost Pension Fund Portfolios, Summer 2024.
[6] PGIM Real Estate, *Four Compelling Reasons to Diversify with Private Real Estate Credit*, June 2023.
[7] PGIM Real Estate, *Private Real Estate Debt: A Portfolio Risk-Return Enhance Through the Lens of Maximum Drawdowns*, August 2023.
[8] PREA Quarterly, Stability and Resilience in Uncertain Times: The Strategic Role of Core Real Estate Debt in Fixed Income Portfolios, Winter 2024.

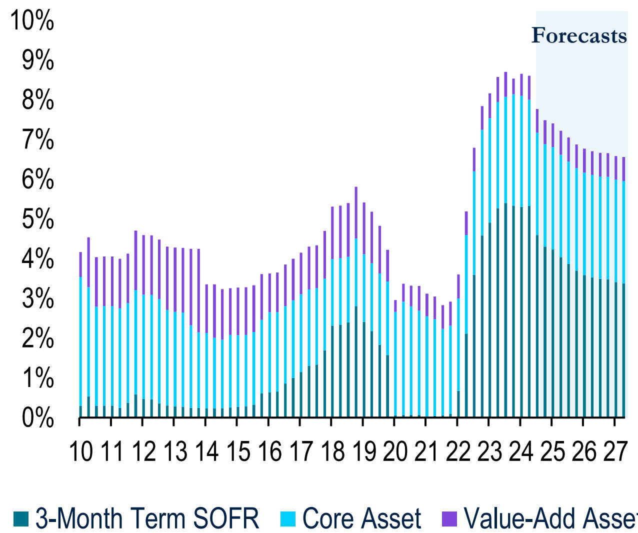
3 Improved Risk-Return Profile

Capitalizing on normalizing interest rates and a real estate market recovery

- The rise in interest rates has benefited floating-rate loans by increasing coupons, and thus, absolute returns on private CRE credit investments.
- Private CRE credit will continue to offer high current income, even as interest rates moderate (**Exhibit 3**).
- While elevated coupons may strain a borrower's ability to pay interest, the expected recovery in the real estate market will enhance property cash flows, improving debt serviceability.
- Loans originated now are expected to experience declining credit risk over time as income and property values are forecast to grow (**Exhibit 4**).
- Higher income and stronger credit fundamentals together provide the potential for solid returns on new CRE credit investments.

Exhibit 3: High Current Income From Normalizing Rates

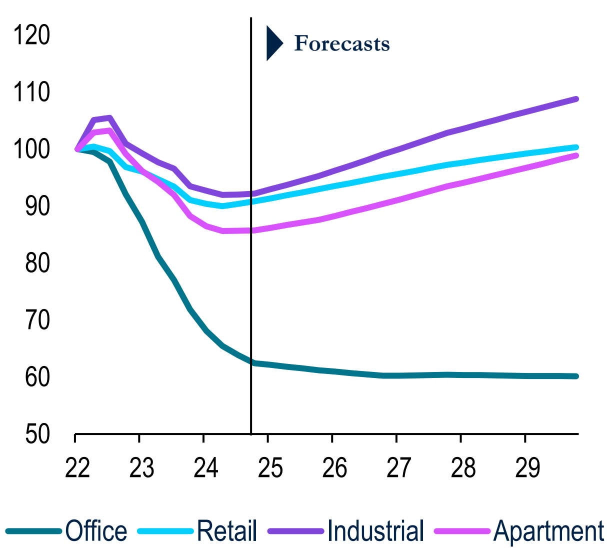
New Loan Coupons on Floating Rate Loans



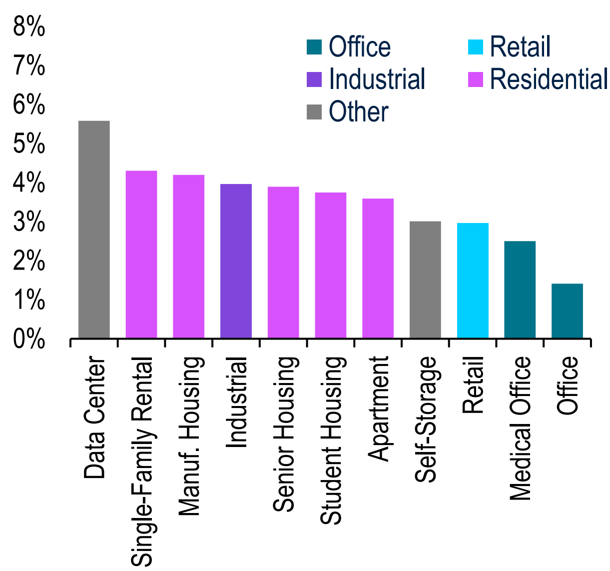
New loan coupon estimates are based on a market average 5Y floating-rate loan collateralized by a core or a value-add asset.
Sources: Bloomberg, PGIM Real Estate. As of April 2025.

Exhibit 4: Credit Fundamentals Strengthen as Real Estate Property Values and Income Streams Improve

Capital Appreciation Index (1Q22 = 100)



2025-29 NOI Growth Forecast



Sources: NCREIF, PGIM Real Estate. As of April 2025.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

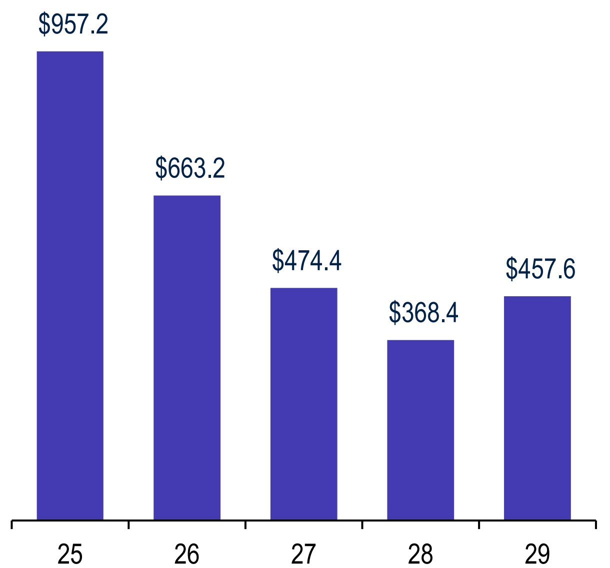
4 Growing Need for Debt Capital

Addressing maturity, modernization and bank regulatory pressures

- **Maturity Wall**: High volume of maturities, due to loan modifications and extensions, drive demand for refinancing solutions (**Exhibit 5**).
- **Capex Shortfalls**: Increasing need for capital to modernize and institutionalize existing stock, as many buildings were underinvested in the last cycle (**Exhibit 6**).
- **Demand from Value-Add Equity Strategies**: Rising fundraising for CRE value-add strategies signals greater need for debt capital to support value creation business plans (**Exhibit 7**).
- **Bank Regulatory Uncertainty**: Banks are taking a cautious and highly selective approach, creating demand for alternative debt sources and flexible financing solutions.

Exhibit 5: Increased Refinancings From Maturity Spike

Commercial and Multifamily Loan Maturity Schedule ($Bn)

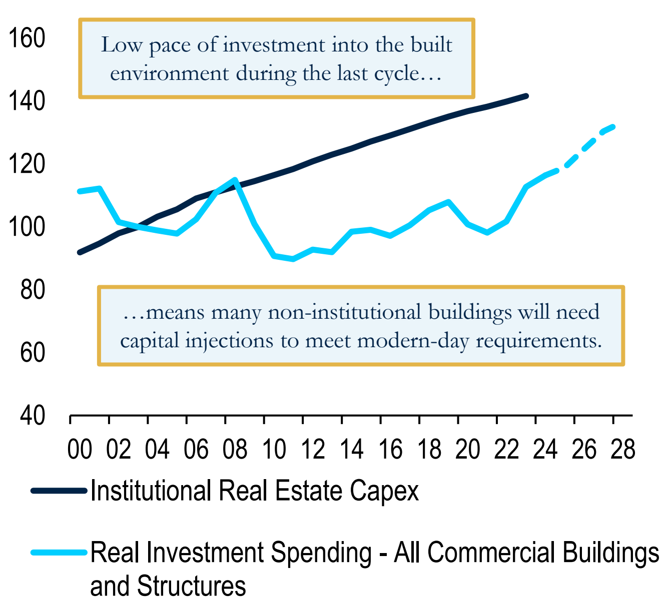


Sources: Mortgage Bankers Association, PGIM Real Estate. As of April 2025.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Exhibit 6: Need for Capital to Address Capex Shortfalls

Index of U.S. Capex Spending (2003 = 100)

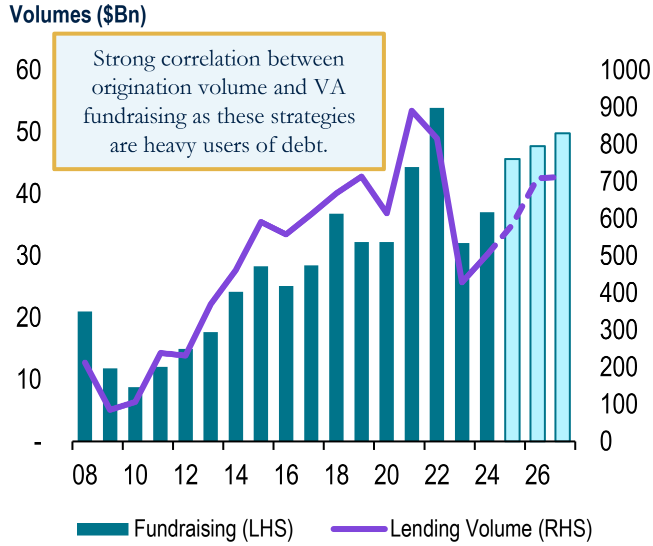


Sources: MSCI, OECD, Oxford Economics, PGIM Real Estate. As of April 2025.

Forecasts are not guaranteed and may not be a reliable indicator of future results.

Exhibit 7: Rising Demand for Private Credit Indicated by Growth in Value-Add Equity Fundraising

Fundraising for Value-Add Equity Strategies and CRE Lending Volumes ($Bn)



Fundraising activity refers to the North America region. Lighter bars and dotted lines represent forecasts.
Source: Mortgage Bankers Association, Preqin, PGIM Real Estate. As of April 2025.

For Professional and Institutional Investors only. All investments involve risk, including the possible loss of capital.

5 Expanding Opportunity Set

Growing universe of property types drives diverse opportunities

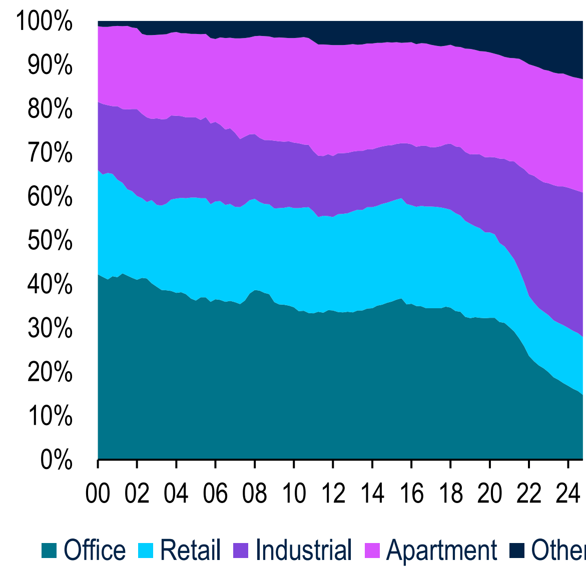
The private CRE credit market offers broad exposure across various economic sectors offering diversification benefits across a portfolio.

However, the real estate investment universe is evolving, driven by a growing range of property types, creating an even broader range of investment opportunities with even more diverse exposures (**Exhibit 8**).

A notable shift toward more operational assets, including senior living, self-storage, data centers, student housing, co-living and hotels (**Exhibit 9**), reflects a focus on income generation. These assets require intensive asset management, opening up new avenues for financing value creation strategies.

Exhibit 8: The Real Estate Investment Universe Is Evolving

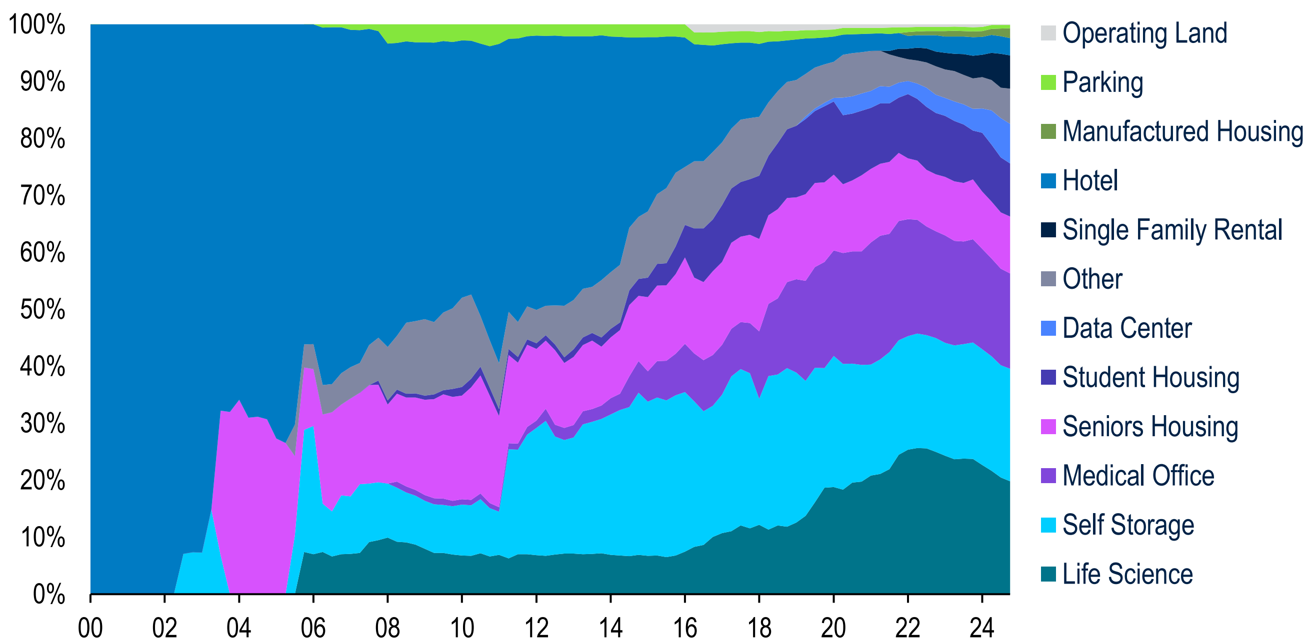
NCREIF Sector Allocations



Sources: NCREIF, PGIM Real Estate. As of April 2025.

Exhibit 9: Growing Universe of Property Types Shifting Toward More Operational-Intensive Assets

NCREIF Sector Allocation Within "Other" Property Types



Sources: NCREIF, PGIM Real Estate. As of April 2025.

For Professional and Institutional Investors only. All investments involve risk, including the possible loss of capital.

Key Drivers Shaping Private Credit Opportunities

As we enter a new market cycle for real estate, the outlook for private real estate credit is promising, driven by both tactical and structural factors that create an attractive investment landscape.

Higher interest rates, improving credit fundamentals and the need for real estate modernization provide a favorable backdrop for credit opportunities. Additionally, the growth of operational sectors and the expanding universe of property types offer further investment potential.

However, while uncertainty continues to challenge sentiment and activity, it is important to remain mindful of the potential risks ahead, including the possibility of interest rates staying elevated for longer. This could delay the real estate market recovery and push market participants back to the sidelines, which would reduce the volume of opportunities.

In this environment, careful investment selection is crucial. Below, we highlight key drivers shaping the private real estate credit landscape, positioning it as a resilient asset class amid market uncertainty.

Tactical and Structural Drivers of Lending Opportunities

TACTICAL DRIVERS

- Normalized interest rates in the next real estate market cycle will support robust interest income, even as rates moderate.
- Improving credit risk as cash flows and property values grow, leading to better LTV and DSCR, reducing downside risk.
- Substantial investment needed to modernize and institutionalize existing real estate stock.
- High volume of upcoming maturities, along with growing demand for financing to meet expected increase in transactions.

STRUCTURAL DRIVERS

- Bank regulatory uncertainty drives demand for alternative capital sources and flexible financing solutions.
- A supportive back-leverage market will enhance liquidity, boosting returns and improving overall lending conditions.
- Expanding universe of property types offers broader economic sector exposure, creating diverse investment opportunities.
- Growth in operational sectors creates more opportunities to finance value creation business plans.

Contacts

Henri Vuong
Executive Director
Head of Debt Investment

John Jacobs
Managing Director
Senior Portfolio Manager, U.S. Core Plus Debt Strategy

Dean Joseph Deonaldo
Investment Vice President
Americas Investment Research

Jeremy Keenan
Managing Director
Portfolio Manager, U.S. Core Plus Debt Strategy

Important information

Important information *(continued)*

GENERAL/CONFLICTS OF INTEREST

These materials represent the views, opinions and recommendations of the author(s) regarding the economic conditions, asset classes, securities, issuers or financial instruments referenced herein. Distribution of this information to any person other than the person to whom it was originally delivered and to such person's advisers is unauthorized, and any reproduction of these materials, in whole or in part, or the divulgence of any of the contents hereof, without prior consent of PGIM Real Estate is prohibited. Certain information contained herein has been obtained from sources that PGIM Real Estate believes to be reliable as of the date presented; however, PGIM Real Estate cannot guarantee the accuracy of such information, assure its completeness, or warrant such information will not be changed. The information contained herein is current as of the date of issuance (or such earlier date as referenced herein) and is subject to change without notice. PGIM Real Estate has no obligation to update any or all of such information; nor do we make any express or implied warranties or representations as to the completeness or accuracy or accept responsibility for errors.

These materials are not intended as an offer or solicitation with respect to the purchase or sale of any security or other financial instrument or any investment management services and should not be used as the basis for any investment decision. Past performance is no guarantee or reliable indicator of future results. No liability whatsoever is accepted for any loss (whether direct, indirect, or consequential) that may arise from any use of the information contained in or derived from this report. PGIM Real Estate and its affiliates may make investment decisions that are inconsistent with the recommendations or views expressed herein, including for proprietary accounts of PGIM Real Estate or its affiliates.

The opinions and recommendations herein do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments or strategies to particular clients or prospects. No determination has been made regarding the suitability of any securities, financial instruments or strategies for particular clients or prospects. For any securities or financial instruments mentioned herein, the recipient(s) of this report must make its own independent decisions.

Conflicts of Interest: Key research team staff may be participating voting members of certain PGIM Real Estate fund and/or product investment committees with respect to decisions made on underlying investments or transactions. In addition, research personnel may receive incentive compensation based upon the overall performance of the organization itself and certain investment funds or products. At the date of issue, PGIM Real Estate and/or affiliates may be buying, selling, or holding significant positions in real estate, including publicly traded real estate securities. PGIM Real Estate affiliates may develop and publish research that is independent of, and different than, the recommendations contained herein. PGIM Real Estate personnel other than the author(s), such as sales, marketing and trading personnel, may provide oral or written market commentary or ideas to PGIM Real Estate's clients or prospects or proprietary investment ideas that differ from the views expressed herein. Additional information regarding actual and potential conflicts of interest is available in Part 2 of PGIM's Form ADV.

INFORMATIONAL PURPOSES

These materials are for informational or educational purposes. In providing these materials, PGIM (i) is not acting as your fiduciary and is not giving advice in a fiduciary capacity and (ii) is not undertaking to provide impartial investment advice as PGIM will receive compensation for its investment management services.

These materials do not take into account the investment objectives or financial situation of any client or prospective clients. Clients seeking information regarding their particular investment needs should contact their financial professional.

The information contained herein is provided on the basis and subject to the explanations, caveats and warnings set out in this notice and elsewhere herein. Any discussion of risk management is intended to describe PGIM Real Estate's efforts to monitor and manage risk but does not imply low risk.

These materials do not purport to provide any legal, tax or accounting advice. These materials are not intended for distribution to or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation.

留意事項

◆ 本資料は、PGIMリアルエステートが作成したものです。PGIMリアルエステートは、米国SECの登録投資顧問会社であるPGIMインクの不動産運用ビジネス部門として、PGIMインクを通じて業務を行っています。

◆ 本資料は、情報提供を目的とするものであり、特定の金融商品の勧誘又は販売を目的としたものではありません。また、本資料に記載された内容等については今後変更されることもあります。

◆ 記載されている市場動向等は現時点での見解であり、これらは今後変更することもあります。また、その結果の確実性を表明するものではなく、将来の市場環境の変動等を保証するものでもありません。

◆ 本資料に記載されている市場関連データ及び情報等は信頼できると判断した各種情報源から入手したものですが、その情報の正確性、確実性について当社が保証するものではありません。

◆ ここに記載されているモデル・アロケーションは例示を目的としたものであり、個別銘柄の購入や売却など、いかなる投資の推奨も目的としたものではありません。また、当社グループが運用するポートフォリオにおける今後の投資行動について示唆するものでもありません。

◆ 過去の運用実績は、必ずしも将来の運用成果等を保証するものではありません。

◆ 本資料に掲載された各インデックスに関する知的財産権及びその他の一切の権利は、各インデックスの開発、算出、公表を行う各社に帰属します。

◆ 本資料は法務、会計、税務上のアドバイスあるいは投資推奨等を行うために作成されたものではありません。

◆ PGIMジャパンによる事前承諾なしに、本資料の一部または全部を複製することは堅くお断り致します。

◆ “Prudential”、“PGIM”、それぞれのロゴおよびロック・シンボルは、プルデンシャル・ファイナンシャル・インクおよびその関連会社のサービスマークであり、多数の国・地域で登録されています。

◆ PGIMジャパン株式会社は、世界最大級の金融サービス機関プルデンシャル・ファイナンシャルの一員であり、英国プルーデンシャル社とはなんら関係がありません。

会社概要

商号	PGIMジャパン株式会社
	PGIM Japan Co., Ltd.
所在地	東京都千代田区永田町 2-13-10 プルデンシャルタワー
代表取締役社長	國澤 太作
設立年月日	2006年4 月19日
主要株主	Prudential International Investments Company, LLC (100%)
資本金	2億1,900万円
主要業務	① 投資運用業
	② 投資助言・代理業
	③ 第二種金融商品取引業
登録番号等	金融商品取引業者 関東財務局長（金商）第392号
加入協会	一般社団法人投資信託協会
	一般社団法人日本投資顧問業協会
	一般社団法人第二種金融商品取引業協会

PGIMJ118093
4419849_20250417