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Real Estate: Uncovering Value Amid Uncertainty

Five years after the COVID-19 pandemic sent tremors through the real estate industry, many skittish capital providers remain on the sidelines. While uncertainty persists amid concerns about the impacts of higher tariffs, potential construction labor shortages and the path of inflation, we believe evolving market dynamics have begun to favor well positioned investors across the sector.

In this paper, we explore how prevailing conditions—including reduced commercial property values, higher interest rates, demand for liquidity and lack of housing supply—are opening a variety of opportunities to generate attractive risk-adjusted returns.

Executive Summary

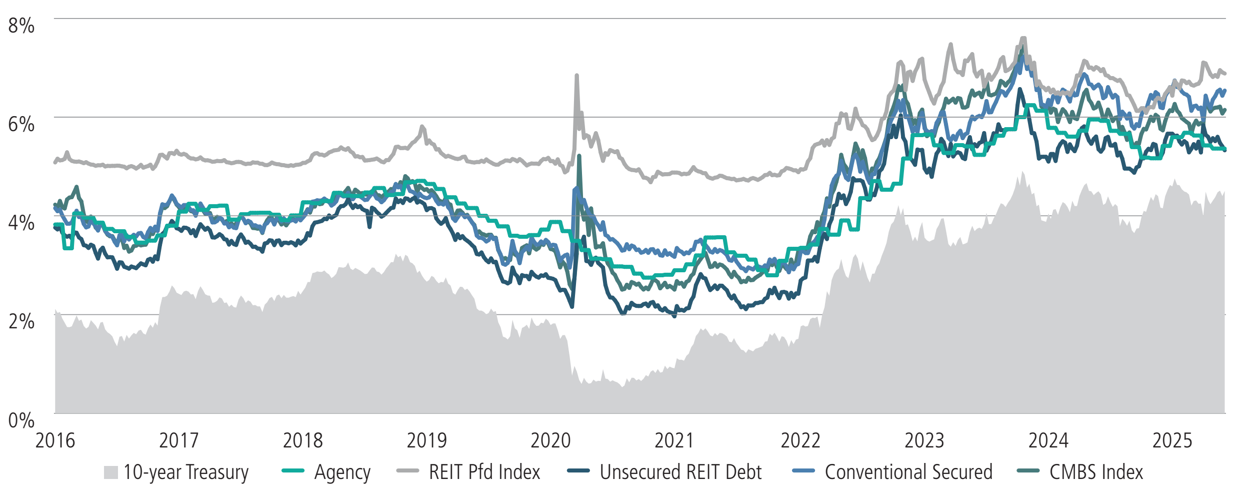
Five years after the COVID-19 pandemic sent tremors through the real estate (RE) industry, we believe evolving market dynamics are opening more opportunities for well positioned investors across the sector.

- With the notable exception of residential real estate, which has continued to show resilience, property values have fallen significantly across certain asset classes. At current levels and amid lingering uncertainty, we see opportunities for *investors who can provide capital solutions and other strategic financing to private real estate companies looking to right-size their capital structures and execute more efficiently on their pipelines.*
- Higher interest rates and economic uncertainty have chilled transaction activity and reduced liquidity, creating potentially attractive opportunities for *secondary investors who can supply liquidity for RE fund general partners (GPs) and limited partners (LPs).*
- As many operators face a looming debt-maturity wall, and skittish banks continue to limit their RE exposure, we believe experienced opportunistic and *"special situations" investors may be able to generate attractive returns by providing liquidity to capital-starved borrowers or restructuring loans on specific commercial properties.*
- Supply of residential properties trails current demand in many markets, while demographic trends suggest increasing growth in household formations. As interest rates have risen and many banks remain retrenched, we believe *private transitional lenders have the potential to generate attractive returns by financing the refurbishment of older housing stock and construction of new dwellings in key markets.*

The Lay of the Land

The COVID-19 pandemic upended various asset classes across the RE landscape, notably including commercial real estate (CRE) and senior housing. On the CRE front, demand for office space dwindled and has largely remained under pressure from the seismic shift to hybrid work that followed. By mid-2022, pandemic-driven supply-chain bottlenecks and aggressive fiscal stimulus had sent inflation north of 9%, compelling the Federal Reserve to hike interest rates, which in turn increased CRE borrowing costs (see figure 1) and lowered property values (see figure 2).

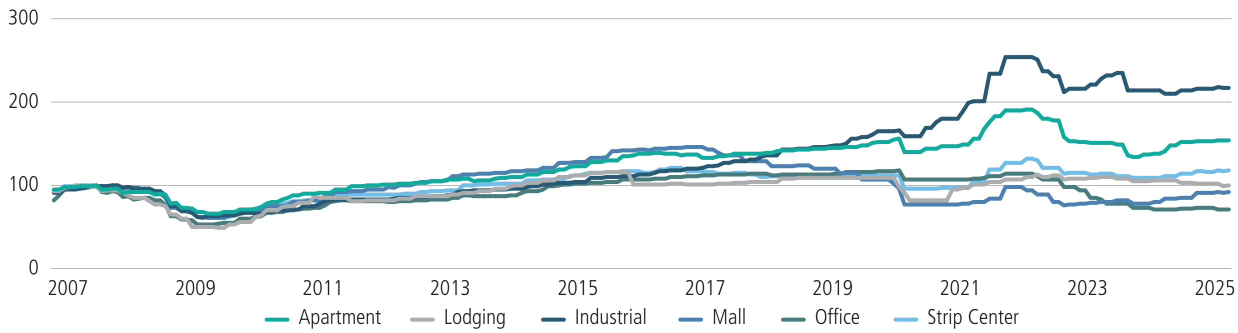
FIGURE 1: RISING BORROWING COSTS HAVE SQUEEZED REAL ESTATE OPERATING PROFITS



Source: Green Street Commercial Mortgage Alert; data as of 4/11/2025.

Commercial Property Price Indices

FIGURE 2: COMMERCIAL PROPERTY PRICES HAVE TUMBLED BETWEEN 10% AND 37% ACROSS AN ARRAY OF SUBSECTORS SINCE 2022



Source: Green Street Real Estate Alert as of 4/1/2025.

At the same time, shortages of lumber, steel and other building materials led to project delays, cost overruns and reduced profitability for RE owners and managers, while steeper mortgage rates reduced the affordability of existing homes and hampered development of new ones.

Now a burgeoning trade war and stricter U.S. immigration policies threaten to reignite inflation, push up construction costs, limit new projects and further stall transaction activity. While such federal and fiscal policies present an outsized risk to economic growth, a protracted slowdown in construction due to rising replacement costs may limit fresh supply, benefiting owners of existing properties (especially in prime locations) and, perhaps, offering a meaningful hedge against potentially rising inflation.

While considerable uncertainty persists, we believe evolving market dynamics have begun to present potentially attractive opportunities for well positioned investors across the RE landscape. In the following sections, we explore various approaches that seek to capitalize on this potentially pivotal moment in the RE sector.

A Value Hunter's Guide

Strategic & Tactical Capital Solutions for Real Estate Operating Companies

Historically, real estate companies have primarily sought financing for projects through individual joint ventures. However, as the real estate industry continues to institutionalize, so-called "platform" investments are becoming more common. Such financing enables companies to consolidate both the operating company and underlying property interests under one investible entity.

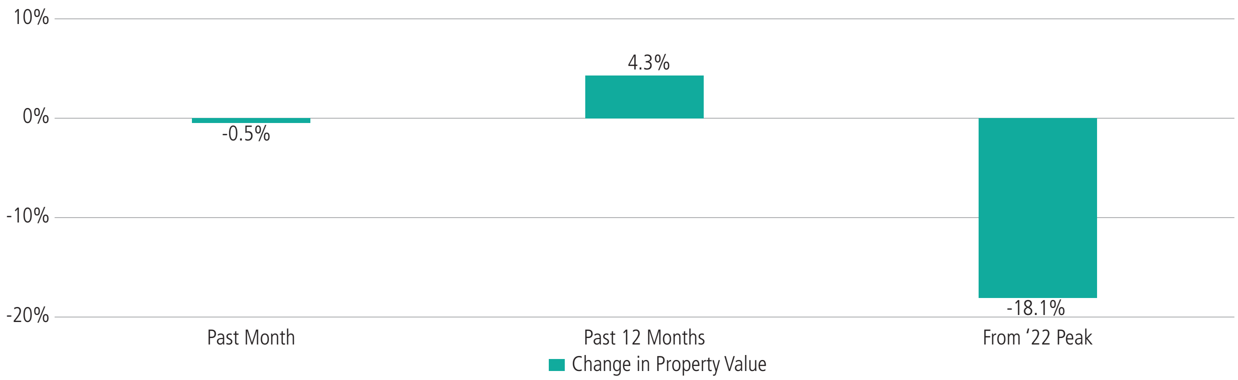
We believe platform-level investing can provide benefits to both operators and investors by a) boosting overall scale, thereby increasing portfolio diversification and potentially facilitating better access to vendors and financing (at both the asset and corporate levels); b) aligning collective interests by incentivizing operators to maximize the value of their entire portfolios, as well as the operating companies, with the potential to earn GP economics; and c) building strategic partnerships that can help operators further institutionalize their businesses and grow.

As current market conditions persist and the trend toward institutionalization continues to evolve, we believe opportunities exist for sophisticated capital providers to make attractive investments into a variety of real estate platforms:

First, as property values pulled back (see figure 3), we find that some high-quality real estate platforms are temporarily over-levered and face near-term capital requirements. This creates an opportunity to provide comprehensive capital solutions to platforms, with funds available to right-size their balance sheets and support future growth. This type of investment will typically be structured as a "hybrid" credit investment—often with a minimum contractual return, warrants or other equity units to participate in the future equity appreciation of the platform, and shared board control.

FIGURE 3: FALLING PROPERTY VALUES ARE CREATING POTENTIALLY ATTRACTIVE OPPORTUNITIES FOR HEALTHY OPERATORS

Change in Commercial Property Values



Source: Green Street Commercial Property Price Index report; data as of May 6, 2025.

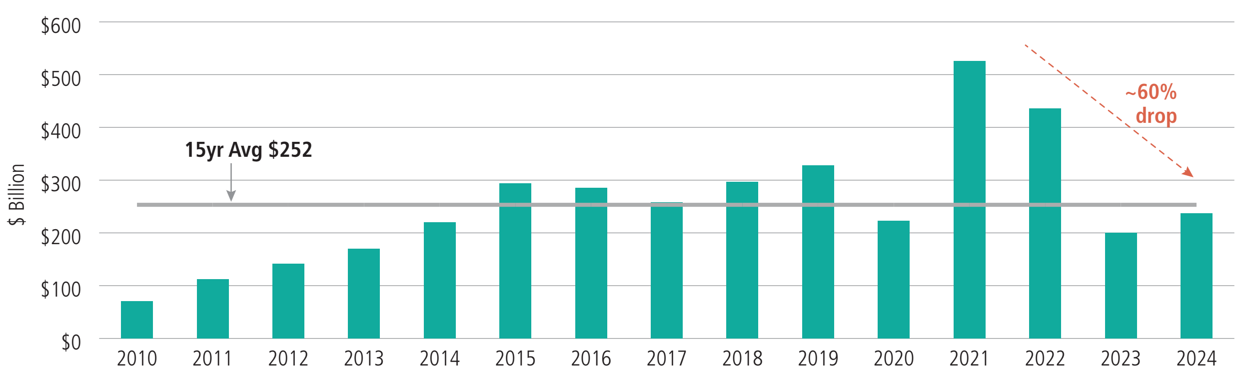
Second, many real estate platforms remain in healthy financial positions, albeit at lower portfolio valuations and with less access to capital. We believe current market conditions create an opportunity to invest in platforms at attractive entry valuations and provide companies ample capital to expand their portfolios through acquisitions or developments. These deals might involve a combination of credit and equity, and include either shared or outright control of a platform's board.

Third, we believe certain alternative asset sectors provide compelling opportunities aligned with long-term investment themes. Data centers, senior housing, storage, cold storage, manufacturing housing, single-family rental and build-to-rent, to name a few, are burgeoning sectors presenting continued growth potential, in our view. While some platforms that target these property types have smaller teams with shorter track records, many are managed by seasoned real estate professionals. Platform-level investments in alternative sectors with higher growth potential typically involve greater amounts of common equity, incorporate control features and may offer higher expected returns.

Real Estate Secondaries

CRE transaction activity has remained well below levels seen before interest rates spiked in the second half of 2022 (see figure 4). This lack of activity has reduced available liquidity to CRE investors. Would-be sellers have held onto assets (reluctant to crystalize the drop in property value that higher rates imply), while potential buyers have had to factor in higher capital costs and persistent economic uncertainty (resulting in bids often well below asking prices).

FIGURE 4: U.S. COMMERCIAL REAL ESTATE TRANSACTION VOLUME HAS FALLEN PRECIPITOUSLY



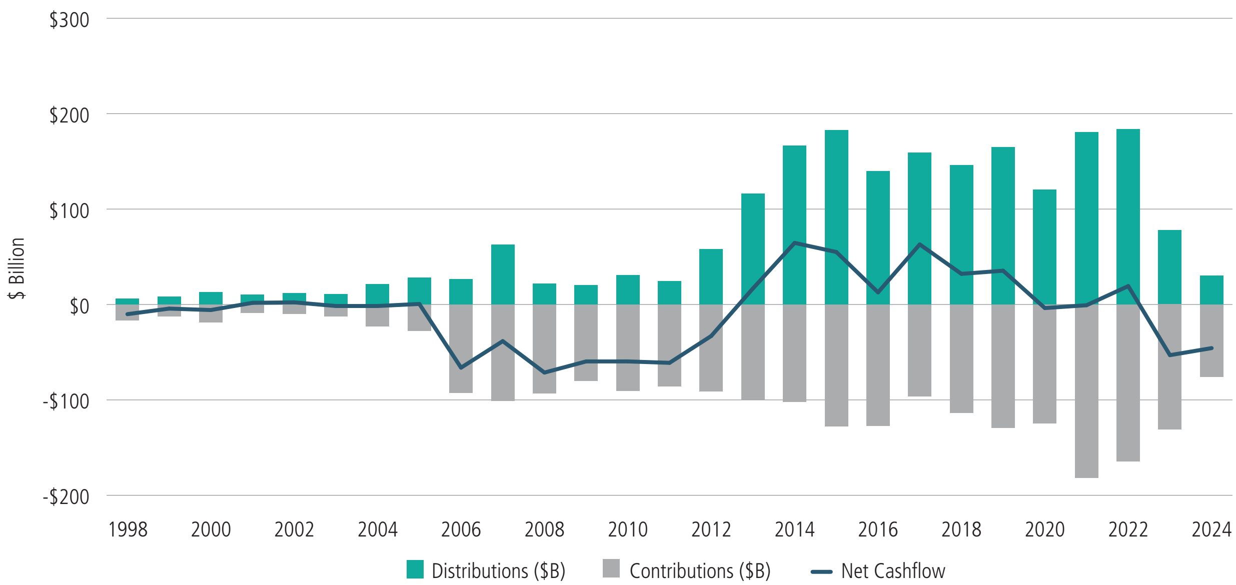
Source: Green Street Advisors, data as of May 2025.

While we've seen signs that the recently wide bid-ask gap has been shrinking, and that transactions have slowly begun to resume, we believe it may be some time before overall volumes recover to more normalized levels.

Furthermore, we believe lackluster transaction activity has clogged up the workings of the real estate fund universe. Unwilling or unable to sell assets in this environment, most funds have essentially paused any meaningful return of capital to investors.

This may be most evident among open-end core RE funds,[1] which have faced steep redemption queues for more than two years; meanwhile, distributions among closed-end funds[2] have slowed to levels not seen since the Global Financial Crisis (GFC), resulting in significantly net-negative cash flows to investors for the first time in more than a decade (see figure 5).

FIGURE 5: INVESTOR CONTRIBUTIONS HAVE BEEN EXCEEDING DISTRIBUTIONS AMONG CLOSED-END REAL ESTATE FUNDS



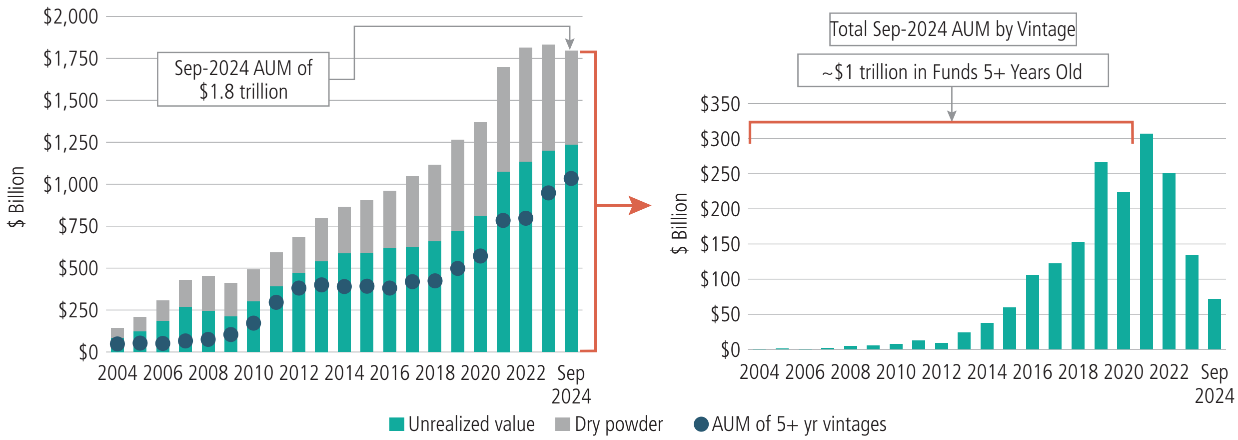
Source: Pitchbook 2024 Annual Global Private Market Fundraising Report.

Reduced realization activity is also reflected in near-record assets under management (AUM) within closed-end funds, particularly in vehicles five or more years old, which ordinarily would put them in harvest mode and actively looking to sell assets. As of September 2024, AUM in these older-vintage funds was more than $1 trillion, a record amount and more than double the levels that prevailed for similarly aged funds in the years prior to COVID (see figure 6). Meanwhile, LPs stuck in legacy RE funds have been waiting for liquidity, making it that much harder for them to make commitments to new ones.

[1] "Open-end" real estate funds have no termination date, with most of the expected return derived from the income generated by the underlying properties. "Core" investments tend to include class A real estate, in prime locations with high-quality tenants, that is purchased with little or no debt.

[2] "Closed-end" real estate funds have a predetermined life, with most of the expected return coming from asset sales rather than income.

FIGURE 6: REDUCED REALIZATIONS HAVE PUSHED AUM AT OLDER REAL ESTATE FUNDS TO RECORD HEIGHTS



Source: Preqin, data as of May 15, 2025. AUM is most recent available.

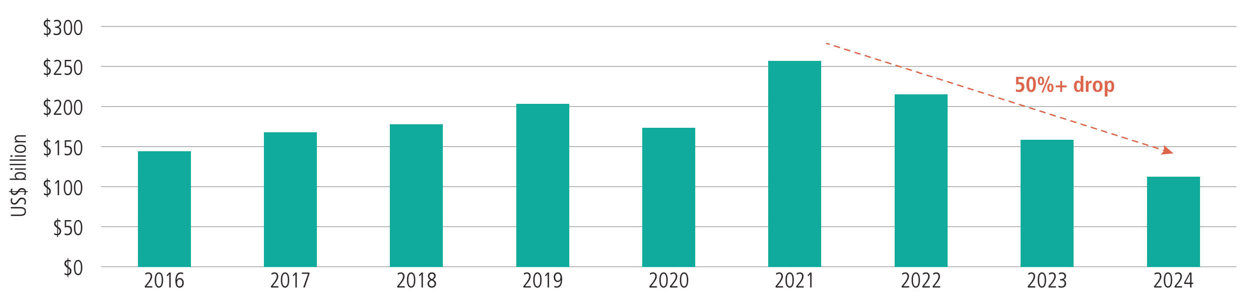
We believe these dynamics continue to create attractive opportunities for suppliers of liquidity in the secondary market. These solutions come in two main forms: traditional "LP-led" secondaries, and increasingly popular "GP-led" secondaries.

LP-led secondaries entail individual investors selling their LP interests in legacy funds to secondary buyers, typically at a discount to reported net asset value. While there remains a substantial bid-ask spread in this part of the RE secondary market (just as in direct markets), we believe that the significant overhang in LPs' demand for liquidity has created a broadening opportunity set for secondary buyers to evaluate. Some of those opportunities may become even more actionable in the near-term, in our view, as (1) direct transaction volumes slowly recover, giving market participants more clarity on pricing; (2) valuations continue to adjust to the current environment, allowing sellers to transact at more acceptable discount levels; and (3) time continues to pass, forcing more sellers to finally throw in the towel on their older fund investments.

By contrast, "GP-led" transactions involve working with fund sponsors to provide liquidity to multiple LPs via the recapitalization of a legacy fund or other investment vehicle. In many of these scenarios, the GP of a legacy fund sells assets from that fund to a new investment vehicle—called a "continuation vehicle" (or CV)—managed by the same GP and set up in negotiation with secondary investors. LPs in the legacy fund typically can either cash out their current stakes or roll them into the new CV, allowing individual LPs to manage their specific duration and cash flow objectives.

Such recapitalizations can allow sponsors to return capital to their LPs while maintaining control of assets that the sponsors believe still have real growth potential. GP-led transactions also present a way for sponsors to retain AUM without having to raise new blind-pool capital, which, as shown in figure 7, has proven very challenging for many sponsors in recent years.

FIGURE 7: FUNDRAISING HAS BECOME MORE CHALLENGING FOR CLOSED-END RE MANAGERS



Source: Preqin, as of May 2025.

To be sure, not all GP-led recaps are created equal for secondary investors in the real estate world.

We believe GP-led transactions that address a true liquidity constraint facing a sponsor and its investors can offer a potential risk-return profile typical of a true secondary strategy. Even beyond current market dysfunction, there are many good reasons why high-quality assets may not be able to attract sufficient liquidity. For example:

- An attractive new property or portfolio may still need time to stabilize and sell.
- A difficult-to-replicate portfolio may have underappreciated growth potential and a correspondingly small current buyer pool.
- A real estate platform or operating company may be in the middle stages of a viable yet longer-term business plan.
- An emerging alternative property sector may have not yet attracted sufficient liquidity.
- A structured and/or fairly complex investment has discouraged many bidders.

On the other hand, some recapitalizations more closely resemble the straightforward acquisition of a property, with the associated risk-return profile that direct purchases entail. In such cases, often involving commodity-like assets in core asset classes such as apartments and warehousing, we believe investors should question why a sponsor is seeking a recap in the secondary market rather than simply selling those assets in the (almost always) deeper direct markets. In our view, recaps involving reasonably liquid real estate should occur at valuations close to, if not at, the pricing available from direct buyers, begging the question of just how attractive—and "secondary-like"—those GP-led deals are to secondary investors.[3]

Another word of caution: While careful asset selection and underwriting are mainly within secondary investors' control, the timing of a sponsor's exit of an underlying investment usually isn't. In today's volatile market environment, it is nearly impossible to say with certainty when an exit opportunity may arise, let alone whether a sponsor will choose to seize it. We believe current secondaries investors therefore need to be particularly cautious in their underwriting to ensure they can withstand extended holding periods and that underlying leverage—another potential landmine—is sustainable.

As in the larger and more established private equity secondary market, we find that RE sponsors are increasingly embracing GP-led recaps as a tool to hold onto their best assets for longer while providing a liquidity off-ramp for legacy LPs. As a result, we believe real estate GP-leds represent a compelling, long-term opportunity for secondary capital. Furthermore, we believe secondary players with the reach and relationships to uncover these opportunities, the skill and resources to carefully underwrite them, and the experience and reputation to secure them, will be at an advantage in this environment.

Capital Solutions for Targeted Assets

Approximately $1 trillion, or 20% of outstanding commercial mortgage debt, is set to mature in 2025.[4] Meanwhile, interest rates have risen, lending standards have tightened, and many traditional lenders remain unwilling to increase exposure to commercial real estate.

This dynamic, in our view, has set the stage for opportunistic "special situations" investors who are able to deploy capital to support specific assets (as opposed to entire real estate operating companies) in the market's most challenged sectors, such as office and retail. As commercial property valuations have plunged and refinancing deadlines loom, we believe a thirst for liquidity will open potentially attractive opportunities to provide debt capital at favorable terms and acquire high-quality assets at discounted valuations.

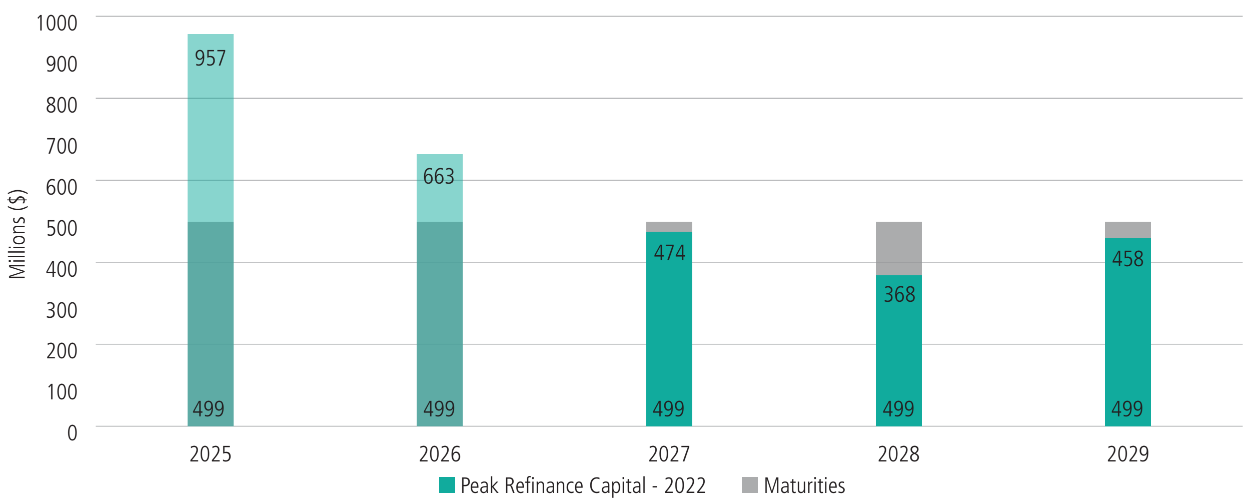
When the U.S. Federal Reserve expanded the money supply in response to the COVID-19 pandemic, small and regional banks increased their CRE exposure. With CRE now accounting for 44% of their loan books, these banks have been scrambling to reduce exposure. We believe the looming maturity wall continues to pose significant challenges across the office, retail and multi-family sectors, with nearly $2 trillion of the $4.7 trillion in outstanding CRE loans set to mature by 2027 (see figure 8). In 2025 alone, $957 billion—or 20% of all CRE loans—will mature, reflecting a sharp increase from prior years.

[3] Sponsors market some transactions as "for sale *or* recap," more or less guaranteeing that secondary buyers will be competing head-to-head with traditional direct buyers. This doesn't necessarily mean these deals are bad; however, we tend to believe that the more liquidity underlying assets can naturally attract, the weaker the argument that selling sponsors are uniquely positioned to add significant value and deliver superior risk-adjusted returns for secondary investors.
[4] Source: "4Q24 State of the U.S. Capital Markets", Newmark, and Mortgage Bankers Association.

While many creditors offered temporary relief on loans that came due in 2024, we believe those extensions ultimately failed to address the drop in underling property values across many subsectors. Most troubling, in our view: The worse a loan's condition, the more likely it was to be extended. As a result, the size of the maturity wall may fall short of the amount of capital available to refinance these loans.

FIGURE 8: THERE IS A LOOMING SHORTFALL OF AVAILABLE CAPITAL TO REFINANCE CRE LOANS COMING DUE

Commercial Real Estate Loan Maturities Versus Historical Peak Refinance Capital

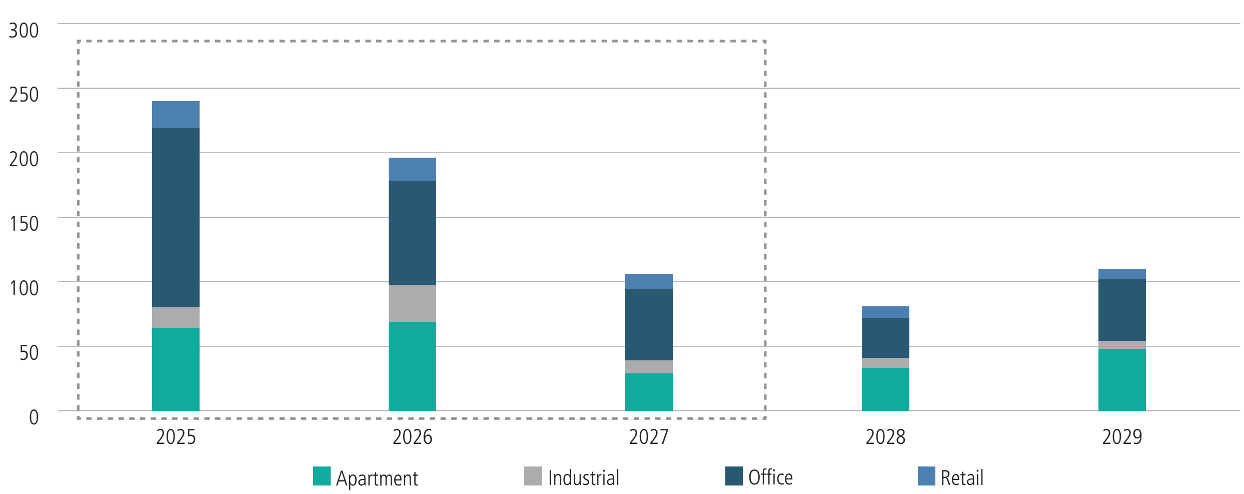


Source: Mortgage Bankers Association, RCA, Newmark; data as of February 2025.

Digging deeper, we have identified approximately $1 trillion worth of "troubled" loans, defined as those with loan-to-value (LTV) ratios of 80% or higher. Over $540 billion of these troubled loans are scheduled to mature between 2025 and 2027, led by loans in the office and multi-family sectors (see figure 9).

FIGURE 9: MORE THAN $500 BN IN TROUBLED LOANS ARE SET TO MATURE OVER THE NEXT THREE YEARS

Troubled Loan Maturities



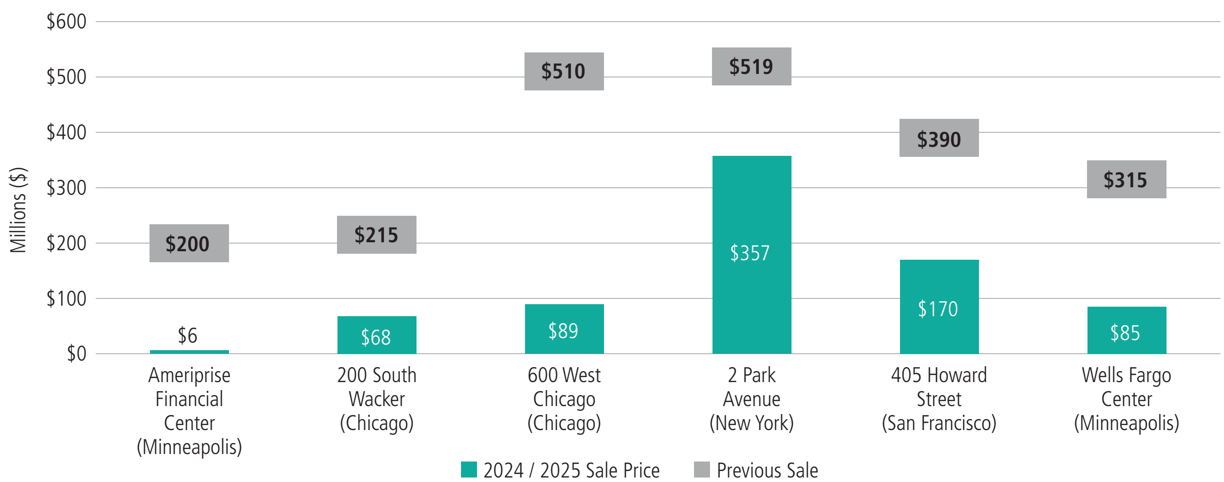
Source: Moodys, Green Street, RCA, Trepp, MBA, Newmark; data as of 1/21/2025.

We believe the office sector is particularly vulnerable, representing 20% of maturing loans in the near term, as remote- and hybrid-work trends continue to suppress demand. Retail loans also continue to face pressure from e-commerce competition, while multi-family loans (comprising 33% of maturing debt through 2026) remain under strain from an oversupply of new units and slowing rent growth in certain locations.

Lack of private capital has left many borrowers unable to meet LTV requirements, forcing them to inject additional equity, sell assets at distressed prices or face default. For office and retail properties with weaker fundamentals, refinancing is proving nearly impossible without significant concessions or restructuring. Recent sales of Class A office properties throughout the country (see figure 10) suggest to us that impending maturities and a lack of refinancing capital may continue to force distressed transactions at deep discounts.

FIGURE 10: NOTABLE CLASS A PROPERTIES HAVE BEEN TRADING AT DEEP DISCOUNTS

Notable Class A Office Sales



Source: Costar, Neuberger Berman.

We believe this challenging environment is creating an array of potential opportunities for skilled special-situations investors, including:

- **Forced sales by "unnatural holders."** In a typical default, lenders may take control of a property, yet lack the resources or desire to own it over the long term. These "unnatural holders" may look to divest the asset in order to pay what they can on the outstanding debt, potentially opening the door for special-situations investors to purchase the asset, reset the basis, inject capital and reposition the property for future growth.
- **Bridge financing for high-quality assets.** During periods of volatility, best-in-class real estate operators may not have access to the broader capital markets. Special-situations investors can provide first mortgage debt, subordinate financing, preferred equity and even direct equity in specific assets as needed.
- **Repositioning insolvent assets to meet current demand.** This approach can take many forms. For example, older retail properties, rendered gradually inviable by the rise of e-commerce, can provide land to meet a community's current residential, hospitality or medical needs. Special-situations investors can buy a property's debt while insolvent, restructure the asset, and work with the community to determine its highest and best use moving forward.
- **New loans at right-sized LTVs and attractive yields.** As banks and other traditional lenders have retrenched, we find that providers of private capital have been able to negotiate favorable terms on core assets.

In our view, experienced special-situations investors—those with rigorous underwriting capability and deep sourcing networks—have the potential to generate attractive risk-adjusted returns at this pivotal juncture for the real estate sector.

Residential Transitional Lending and Homebuilder Finance

The supply of available housing has dwindled relative to demand. J.P. Morgan recently estimated that the U.S. faces a shortage of 2 to 3 million homes, and that "new real estate development is now a pressing social need"; supply-demand mismatches have also cropped up in multifamily, senior-living and workforce-housing sectors, the bank adds.[5] We believe these market dynamics may continue to support asset prices; put upward pressure on rents in select subsectors; and provide a favorable backdrop for providers of "transitional" financing to private residential development and construction companies.

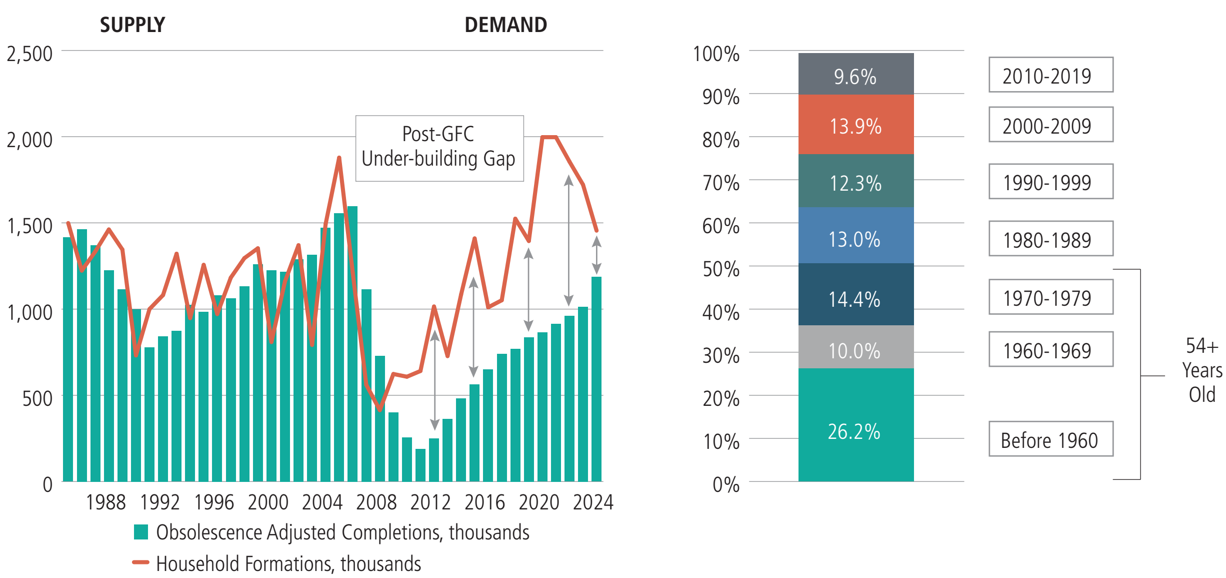
For many investors, residential lending evokes mortgages: multi-decade home-acquisition or home-equity loans. But local and regional homebuilders looking to develop new residences or renovate old ones need debt financing, too. Higher interest rates in recent years have brought increasing attention to this arena as banks have shied away in the aftermath of the GFC.

One potentially attractive approach, in our view, is to build diversified portfolios of smaller, senior-secured, first-lien loans backed by strong credit profiles and spread across key markets to help reduce idiosyncratic risk. These loans are not of the large-scale-CRE variety; rather, they tend to range from $350,000 to $30 million in size, come with slightly lower LTV ratios (typically 60 – 75%), and have relatively short durations (just one or two years). Hence the moniker "transitional" lending.

The fundamentals of this asset class appear particularly attractive to us. Supply of residential properties trails current demand in many markets, while demographic trends suggest rising growth in household formations. As U.S. Millennials entered their 30s during the 2010s, and house prices grew more affordable after the GFC, family formations picked up while net construction lagged. Result: a shortage of some five million units and an aging housing stock (see figure 11), along with rising demand for remodeling in the wake of the pandemic-induced, work-from-home shift. While older homes or apartments can be harder to rent or sell, developers can "reactivate" these properties by borrowing to refurbish them, thereby helping to close the housing gap.

FIGURE 11: CONSTRUCTION OF NEW HOMES HAS TRAILED HOUSEHOLD FORMATION, RESULTING IN SHORTAGES AND AN AGEING HOUSING STOCK, WITH MORE THAN 50% BUILT BEFORE 1980

Post GFC, Family Formations (Demand) Substantially Outpaced Net Construction (Supply): **Shortage of over 5+ Million Units**



Source: U.S. Census Bureau, Morgan Stanley Research. Data as of December 2023.
Source: US Census Bureau, American Community Survey. Data as of 2021.

[5] "Alternative Investments in 2025: Our Top Rive Themes to Watch," J.P. Morgan, March 18, 2025.

In our experience, transitional loans against new residential developments can garner unlevered rates between 9% to 11%, and renovation and bridge loans can offer 8% to 9%.[6] During the near-zero policy-rate environment of 2020 and 2021, those net lending rates were still in the 6% to 8% range.

We believe residential transitional lending may also offer welcome portfolio diversification should interest rates remain elevated or the economy soften in the near-to-medium term, as some market watchers expect.

In the past, as rates rose, housing demand fell as buyers shied away from taking on more burdensome mortgages. Yet that pattern has shifted: While annual rates for conforming 30-year-fixed mortgages shot to a recent 6.9% from 2.7% since January 2020 (a change in magnitude and swiftness not seen since the 1970s),[7] national home prices have *appreciated* by nearly 60%.[8] As long as supply of homes remains constrained, we believe demand will remain resilient, even in an elevated-rate environment.

Furthermore, 90% of outstanding mortgages now carry fixed annual percentage rates, most for as long as 30 years, and many below 4%; in contrast, leading up to the GFC, a material portion of outstanding mortgages carried adjustable rates. Should inflation flare up, compelling the Federal Reserve to maintain elevated interest rates or even raise them from here, bearers of low-fixed-rate mortgages would be less affected than those with floating-rate exposure. And unlike during the housing bubble, when many markets were over-supplied, we believe current housing shortages should help absorb additional supply from potential distressed selling in a softer economy.

Taken together, these dynamics appear to us to favor the residential housing market and, in turn, providers of residential transitional financing. Yet we also believe it takes a special combination of capabilities to capitalize on this opportunity.

In our view, effective transitional lending not only demands rigorous credit underwriting, the technology required for trading loans, and the appropriate loss-mitigation or default-management systems, but also the ability to properly assess residential loan servicer platforms, manage servicer relations and, not least, sourcing attractive lending opportunities in the first place. Finally, we find that nurturing the necessary deal flow to assemble well-diversified transitional-lending portfolios ultimately requires building established relationships with specialized direct-loan-origination companies (or owning them outright), a process that, in our view, can take years of engagement in the market and are difficult to replicate.

[6] As of January 31, 2025. Net lending rates represent typical rates of interest payable by the borrower of a typical loan, net of servicing and origination fees, reflecting Neuberger Berman estimates based on sample lending rates of relevant loans observed in its capacity as discretionary adviser. Typical Net Lending Rates are not indicative of the performance of any Neuberger Berman product and are not intended to represent, and should not be construed to represent, predictions of future yields or rates of return. Investing entails risks, including possible loss of principal. Past performance is no guarantee of future results.

[7] Source: Bloomberg.

[8] Source: Bloomberg.

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