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PRINCIPAL REAL ESTATE

Opportunities in private real estate credit:
Unpacking the $2 trillion wall of maturities

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AT-A-GLANCE

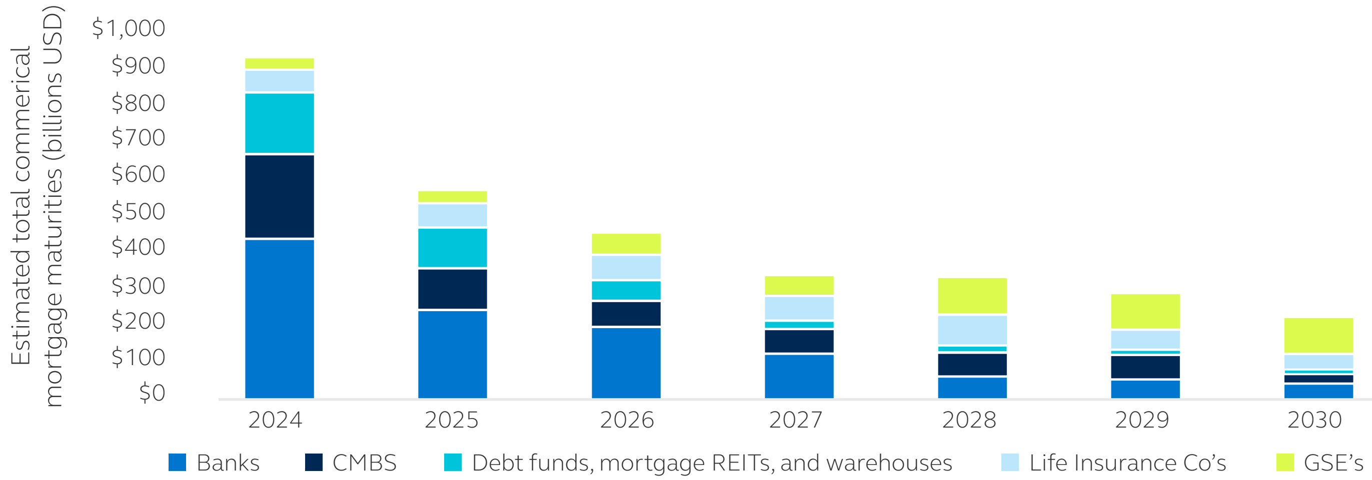
- Approximately $2 trillion in commercial mortgages will mature over the next three years; borrowers will be required to refinance or recapitalize those assets, driving huge demand for capital.
- The “wall of maturities” is the result of huge transaction volumes in commercial real estate in 2021 and 2022.
- The makeup of these maturities is reflective of evolution in the CRE market overall—namely, the decline of office, rise of multifamily, and robustness in the industrial sector.
- The combination of a large share of coming maturities and a robust outlook for multifamily and industrial presents strong opportunities for investment in those sectors.

We believe it’s a good time for credit. One reason is a favorable imbalance between demand for capital (which is high) and supply (which is constrained, as traditional lenders have continued to pull out of the commercial real estate market). As we wrote recently in Why it’s (still) a good time to invest in private real estate credit, “This combination has created a lender’s market, with favorable conditions including rising spreads and total yields.”

Considering the broad-based opportunity in real estate credit today, the wall of maturities is a significant part of the demand side of the story. There are approximately $2 trillion in loans maturing over the next three years. Borrowers will be required to refinance/recapitalize these assets—driving huge demand for capital in an environment marked by waning supply.

Where did this wall of maturities come from? Which sectors are most prevalent? Where will opportunities emerge? We answer those questions here.

EXHIBIT 1: $2 trillion in commercial mortgages will mature over the next three years

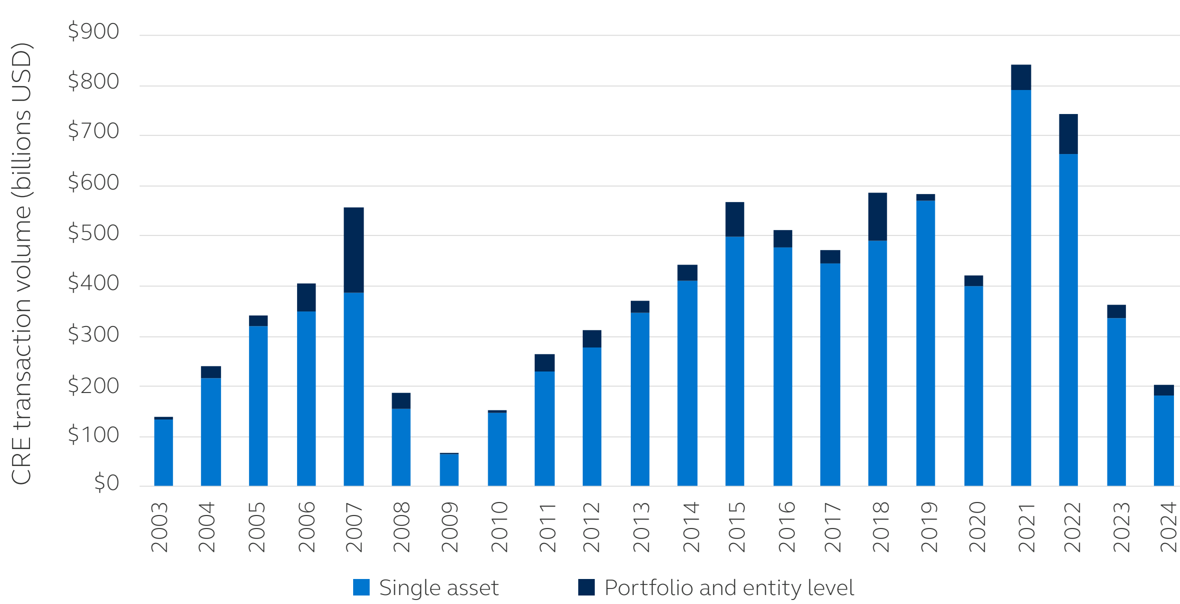


Source: Mortgage Bankers Association, 31 December 2023. CMBS - Commercial mortgage-backed securities GSE – Government-Sponsored Enterprise

The source of the wall of maturities

After the global financial crisis (GFC), commercial real estate (CRE) transaction volumes rebounded slowly, not fully recovering until 2015 (see Exhibit 2). For the next four years, volumes were relatively consistent—until the 2020 pandemic recession, when they fell significantly. The recovery post-COVID was quite different than post-GFC; transactions doubled in 2021 over the previous year, nearly reaching an all-time high. In 2022, transaction volumes were similarly strong.

EXHIBIT 2: 2021 and 2022 were banner years for commercial real estate transactions

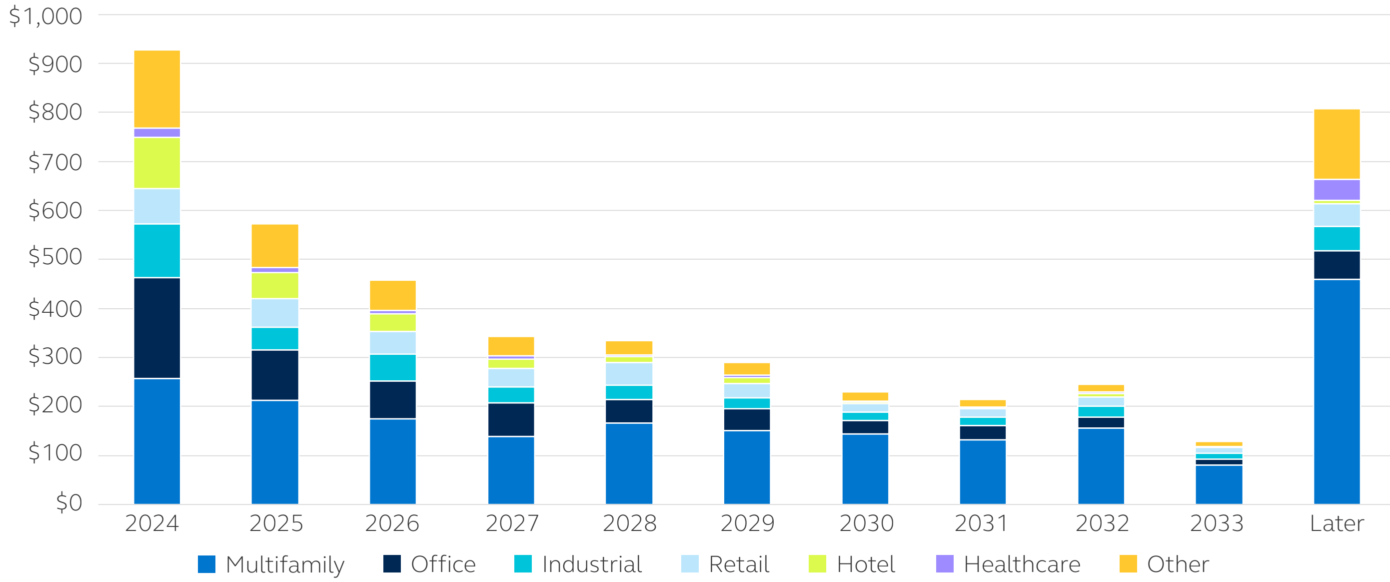


Source: RCA, August 2024

With a mix of 3-year, 5-year, 7-year, and 10-year paper, the first of those 2021 loans are now coming due, and 2022 loans will start to come due next year. Some will be extended, of course, pushing the wall into 2025 and 2026. Of the $700 billion that came due in 2023, $271 billion was extended into 2024, and we expect extensions into 2025 and 2026 as well.

The sectors comprising the wall

EXHIBIT 3: Share of commercial loan maturities through 2033 and beyond



Source: Mortgage Banker Association, December 31, 2023

The wall of maturities reflects commercial real estate loans made between three and ten years ago, so its makeup is reflective of evolution in the CRE market overall—namely, the decline of office, rise of multifamily, and robustness in the industrial sector. Given the multifamily sector's outsized share of CRE transactions in 2020, 2021, and 2022, it should come as no surprise that multifamily makes up the largest single share of commercial loan maturities through 2026.

- The **multifamily** sector makes up 32% of maturities to 2026. The refinancing story is mostly bridge to sale as investors wait for rates to drop and valuations to move back into their favor while debt yield and debt service coverage stabilize. Considering the future investment opportunity, we see tailwinds for multifamily created by persistent challenges in the single-family residential market (while residential mortgage rates are coming down, housing is still very expensive and the housing shortage continues).

- **Office** comprises approximately 14% of maturities to 2026. Only the best deals today will likely find capital as sentiment on office remains extremely low. Distressed investors (those investing in the existing debt of a financially distressed company) could begin to enter the space in a more significant way if "return to the office" momentum builds.

- **Industrial** makes up approximately 10% of maturities to 2026. While we are seeing some softening today, the industrial sector has strong potential driven by the continued growth in e-commerce, which accounts for a rising share of industrial absorption. E-commerce continues to grow 13-14% per year, driving demand for distribution centers, fulfillment hubs, and warehouses. Considering the future investment opportunity, industrial lending is at a slight premium to multifamily today where the opportunity in both stabilized (bridge to sell) and non-stabilized (leasing) is apparent.

- **Retail** makes up close to 9% of the maturities occurring through 2026. This sector took major write-downs after the global financial crisis, and values fell again during and just after the pandemic. Today, however, top retail centers and grocery-anchored retail are performing quite well.

- **Other** property types, including self-storage facilities, mixed-use and mobile homes, makes up around 35% of maturities taking place in 2026.

Opportunities in private real estate credit

The combination of a large share of coming maturities and a robust outlook for multifamily and industrial presents strong opportunities for investment in those sectors. Indeed, multifamily and industrial make up a significant share of Principal Real Estate Debt team's pipeline, along with some more niche property types including student housing, build to rent (BTR), and self-storage.

With the wall of maturities, over the next several years there will be hundreds of billions of dollars in deals in these sectors, and strong opportunities to deploy capital as supply remains constrained.

Principal Real Estate is a full-service debt manager with expertise across lending managed in-house. With our vertically integrated platform, we're able to both close loans in house and service them. We invest across the risk spectrum, the capital stack, and varying deal sizes, giving us a strong vision of the market and enabling broad relationships. We put our 60 years' of private debt investment experience to work for our clients and they're able to benefit from our broad four quadrant real estate experience.[1]

[1] Experience includes investment management activities of predecessor firms beginning with the investment department of Principal Life Insurance Company.

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