

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



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

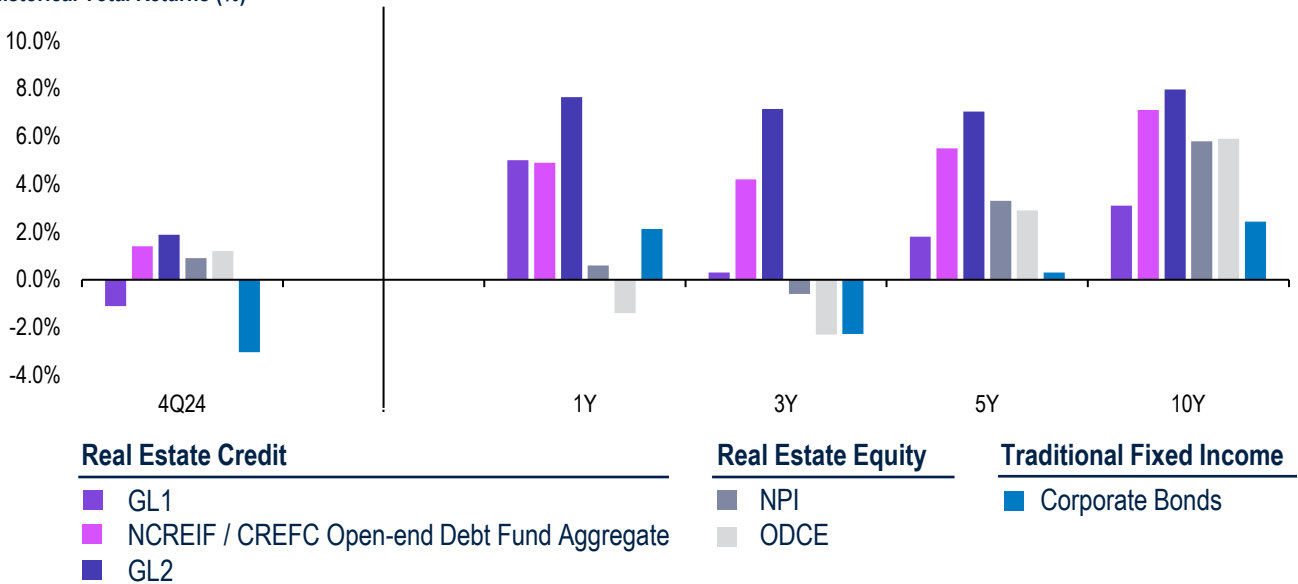
As the market continues to face uncertainty, we are reminded of the stability and resilience of private real estate credit, and the downside protection it brings.

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

Historical Total Returns (%)



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.

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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.

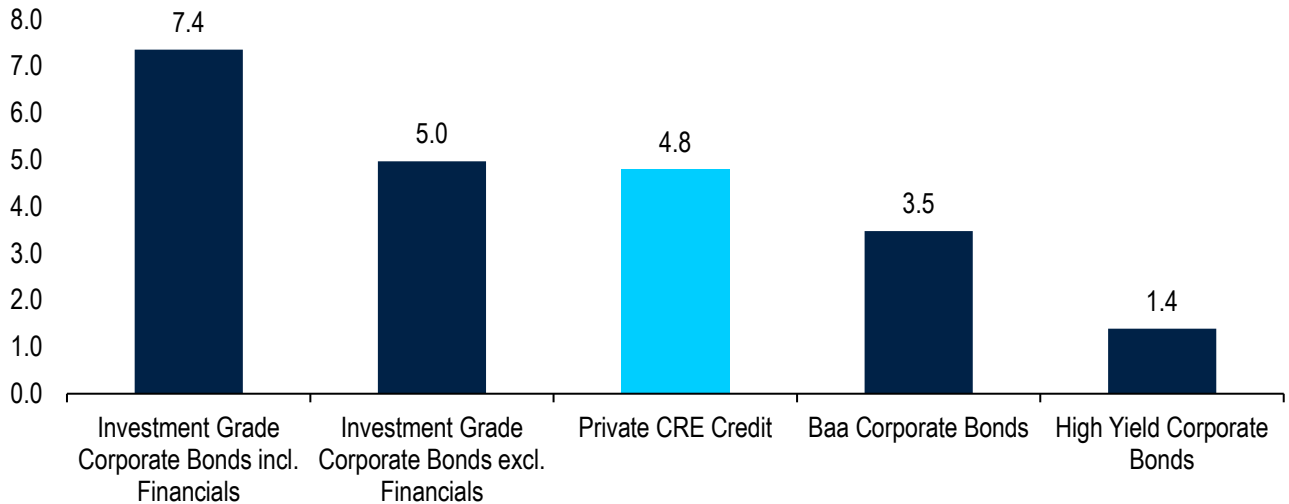
2 Portfolio Enhancing Features

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.

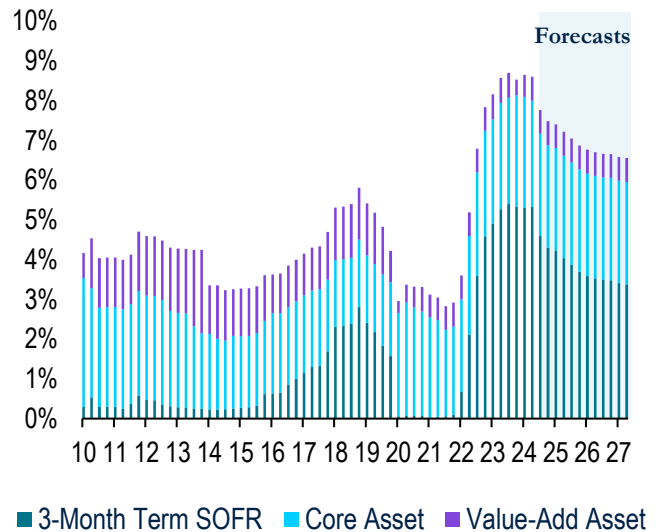
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3 Improved Risk-Return Profile

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

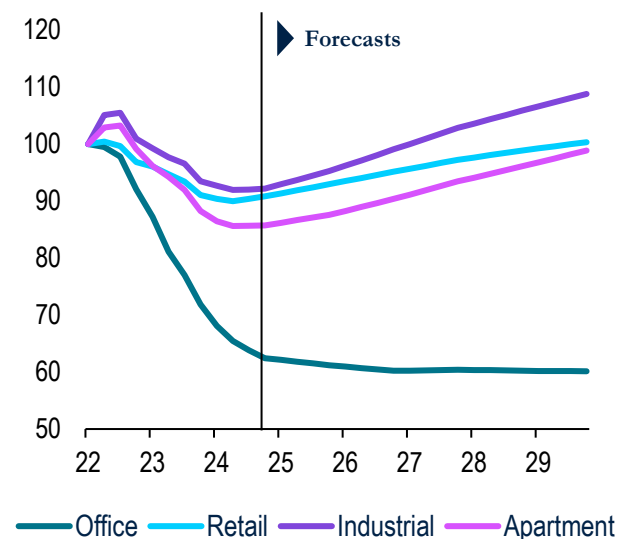


■ 3-Month Term SOFR ■ Core Asset ■ Value-Add Asset

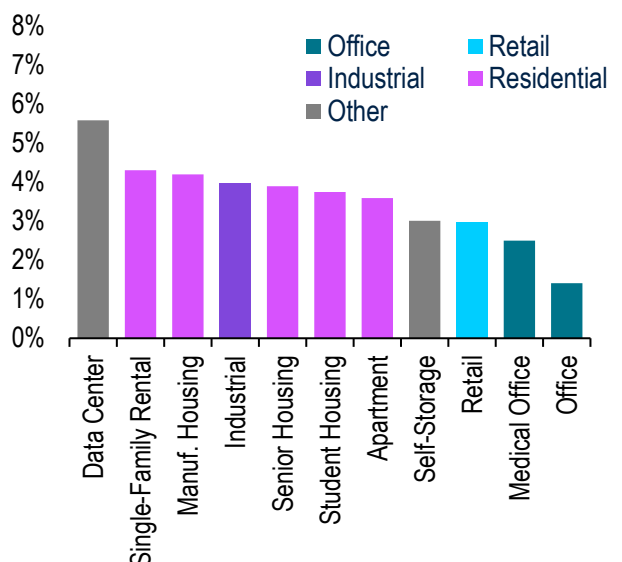
New loan coupon estimates are based on a market average 5Y floating-rate loan collateralized by a core or a value-add asset.
Sources: Bloomberg, PGIM Real Estate. As of April 2025.

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.

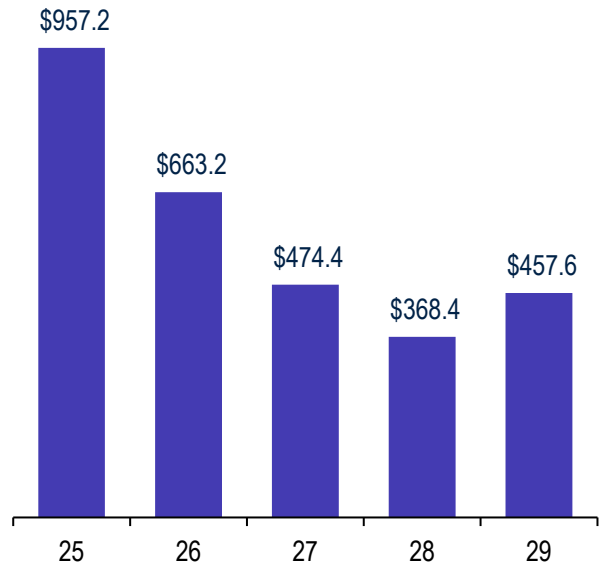
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4 Growing Need for Debt Capital

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.

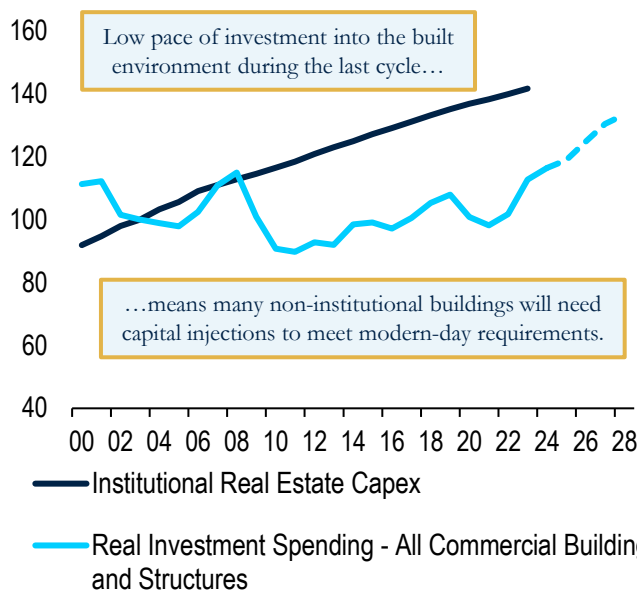
Exhibit 5: Increased Refinancings From Maturity Spike
Commercial and Multifamily Loan Maturity Schedule (\$Bn)



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)



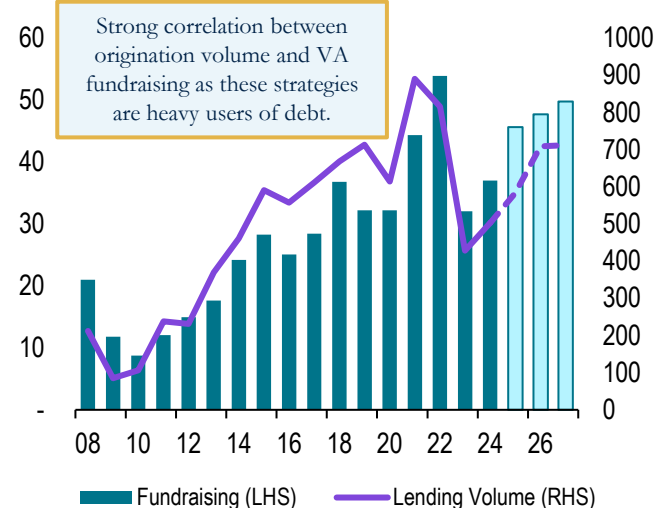
Sources: MSCI, OECD, Oxford Economics, PGIM Real Estate. As of April 2025.

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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, Prequin, PGIM Real Estate. As of April 2025.

5 Expanding Opportunity Set
 Growing universe of property types drives diverse opportunities

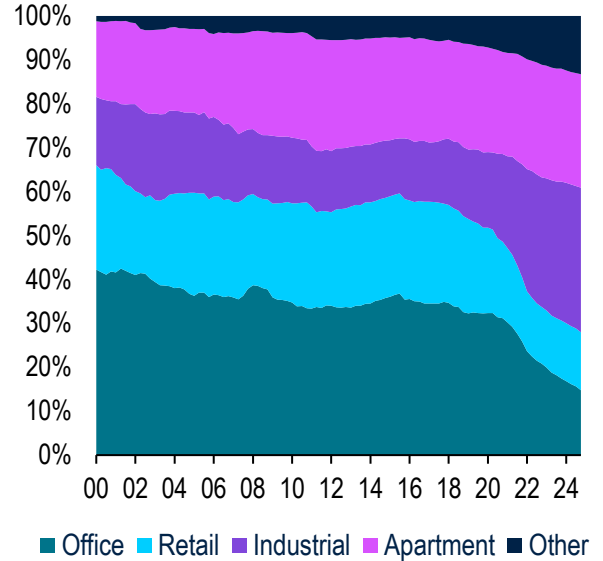
The private CRE credit market offers broad exposure across various economic sectors offering diversification benefits across a portfolio.

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

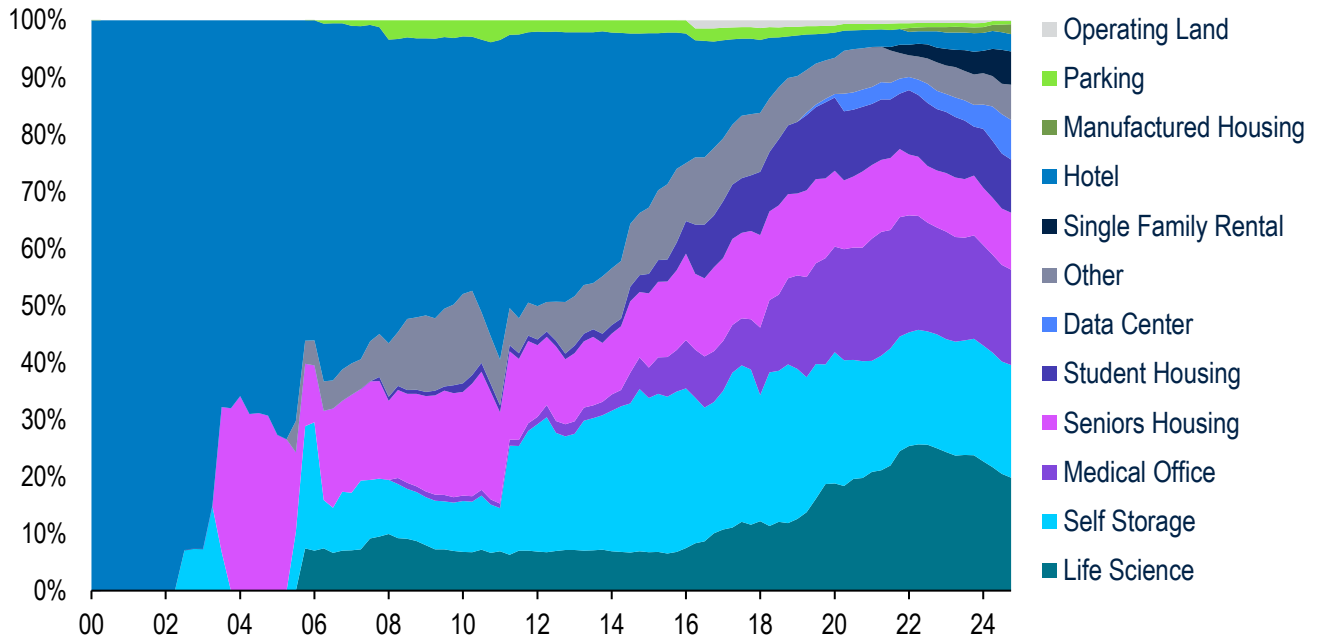
NCREIF Sector Allocations



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.

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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.

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