Opportunities in Real Estate Debt

Public Structured Credit

Publicly traded structured credit instruments linked to real estate may provide investors with attractive potential yields and serve as a complement to private real estate debt holdings.

KEY TAKEAWAYS

- Publicly traded structured credit instruments linked to real estate—such as credit-risk transfer securities (CRTs)—can offer a strategic complement to private real estate debt holdings.
- Backed by high-quality agency mortgages but typically without issuer guarantees, CRTs pay more attractive coupons relative to agency mortgage-backed securities (MBS).
- Pricing inefficiencies can create opportunities to build CRT positions at attractive terms.

In fact, we believe investors that are able to opportunistically manage their exposures to both public and private real estate debt markets may be in a position to capture not only the potential benefits of each but also the relative-value discrepancies that periodically emerge between them.

Agency mortgage-backed securities (MBS)—issued and guaranteed by US government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac—are one of the biggest and most actively traded of the structured credit asset classes. The largest holders of high-quality MBS risk, GSEs have the implicit backing of the US government; agency MBS, as a result, have historically had very little credit risk and pay relatively low spreads. To mitigate their own credit risk exposure, GREs also issue credit-risk transfer securities (CRTs) that reference the same high-quality mortgage pools but carry no issuer guarantee and thus pay more attractive coupons. Like structured credit in general, CRTs are available in tranches of different seniorities and risk/return profiles, enabling investors to tailor their risk exposure.

As a risk-mitigation tool, CRTs are issued programmatically with limited sensitivity to market conditions, and this practice can sometimes give rise to pricing inefficiencies that allow investors to build positions at beneficial terms. Meanwhile, market dislocations—such as the outbreak of Covid-19 in 2020 or the spike in interest rates starting in 2022—historically have presented particularly attractive investment opportunities in CRTs, as the reduction in capital flows accompanying these periods can drive CRT spreads significantly wider even as the underlying mortgage pools' fundamentals are little changed.

Similar high-yielding opportunities can potentially be found through publicly traded instruments linked to mortgage insurance and non-qualifying mortgages.

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Risk Disclosures

All investments involve the risk of loss of principal.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Alternative Investment Risks

Alternative investments can be speculative and are not suitable for all investors. Investing in alternative investments is only intended for experienced and sophisticated investors who are willing and able to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks include:

- Loss of all or a substantial portion of the investment;
- Lack of liquidity in that there may be no secondary market or interest in the strategy and none is expected to develop;
- Volatility of returns;
- Interest rate risk;
- Restrictions on transferring interests in a private investment strategy;
- Potential lack of diversification and resulting higher risk due to concentration within one of more sectors, industries, countries or regions;
- Absence of information regarding valuations and pricing;
- Complex tax structures and delays in tax reporting;
- Less regulation and higher fees than mutual funds;
- Use of leverage, which magnifies the potential for gain or loss on amounts invested and is generally considered a speculative investment technique and increases the risks associated with investing in the strategy;
- Carried interest, which may cause the strategy to make more speculative, higher risk investments than would be the case in absence of such arrangements; and
- Below investment grade loans, which may default and adversely affect returns.

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