Opportunities in Real Estate Debt

Residential Transitional Loans

Despite challenging affordability conditions, the US housing supply continues to significantly lag persistent demand. The undersupply reflects both sluggish new-home construction following the credit dislocations of the global financial crisis and —more recently and more impactfully—the limited inventory of existing homes for sale due to the "lock-in effect" of higher mortgage rates.

KEY TAKEAWAYS

- Demand for housing in the US continues to outpace supply, driven by both sluggish new-home construction and limited inventory of existing homes for sale.
- Residential transitional loans offer home-builders short-term renovation financing in exchange for a source of predictable income with high monthly cash flows.
- With banks pulling back from lending, due to regulatory changes, well-funded investment managers can provide necessary liquidity to homebuilders at potentially attractive terms.

With the median age of an owner-occupied home today standing at 40 years, up from 30 just prior to the global financial crisis[1], the existing homes that do reach the market often require renovation to meet modern living standards.

These dynamics, in our view, should support steady demand for residential transitional loans. These short-duration, value-add loans are typically extended to experienced real estate developers that buy homes with the intent of renovating and reselling them at a profit within a short period of time. They are also usually employed in the multifamily space by real estate investors looking to upgrade the condition of legacy properties to command higher rents. In both cases, the loans are secured by the underlying property, offering capital providers a source of predictable income with attractive monthly cash flows.

Commercial banks were traditionally the main providers of residential transitional loans, but regulatory changes following the global financial crisis have forced them to pull back from the market considerably.[2] A fragmented collection of specialty lenders have stepped up to fill in the financing gaps, but the majority lack the capital to underwrite and hold these loans at meaningful scale. Well-funded investment managers have the necessary capital to do so, and we believe those with strong originator relationships are likely to have consistent opportunities to selectively purchase individual loans at attractive terms, and use these loans to construct broadly diversified client portfolios with attractive risk-adjusted return potential.

1. Source: American Community Survey Estimates; data as of December 31, 2021, the latest information reported.
2. Source: Federal Deposit Insurance Corporation; data as of December 31, 2024.

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- Absence of information regarding valuations and pricing;
- Complex tax structures and delays in tax reporting;
- Less regulation and higher fees than mutual funds;
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