Commercial Real Estate Debt is a robust asset class

Stability and Income

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CRED has delivered robust performance even amidst economic downturns, owing to its pronounced heterogeneity, diverse investment opportunities, and adaptable financing structures.

Senior mortgages in the commercial sector in the USA represent a huge asset class of approximately $5.6 trillion, which is more than three times the size of the market for US high-yield bonds. Amidst current challenges, the market for Commercial Real Estate Debt (CRED) proves to be a resilient option for investors. Due to its significant heterogeneity, diverse investment opportunities, and financing structures, CRED has delivered solid returns even in a recessionary environment. This is attributed to its priority in the capital structure, which provides investors with both a stable income source and capital protection.

Performance Valvest Steady Income Fund (Class A-USD, netto)*

Challenges for Banks and Opportunities for Alternative Lenders

In recent months, the situation has worsened for certain participants in the US commercial real estate market. On one hand, this poses particular challenges for real estate investors, as rental income may not be sufficient to cover the increased loan costs associated with short-term mortgages. On the other hand, banks that have extended overly large loans also face a challenge. While the solvency of financial institutions is not immediately threatened, their revenue potential is reduced due to increased provisioning for potentially defaulting mortgages.

Mortgages for office properties, a particularly concerning segment, constitute 15% of the entire commercial real estate market. Projections indicate that approximately $53 billion of these office loans will default, which in turn represents slightly over 1% of the entire CRED market. Of these projected defaults, around $26 billion are attributed to banks, reflecting 1.5% of the total banking assets. Due to these figures, the risks of the current market situation are contained. The rating agency Fitch emphasizes that lending for commercial real estate does not pose a systemic risk, mainly due to improved credit standards since the global financial crisis. Measures such as stricter reserve requirements and more transparent accounting methods help banks identify and gradually manage potential losses, reducing the likelihood of significant one-time write-downs.

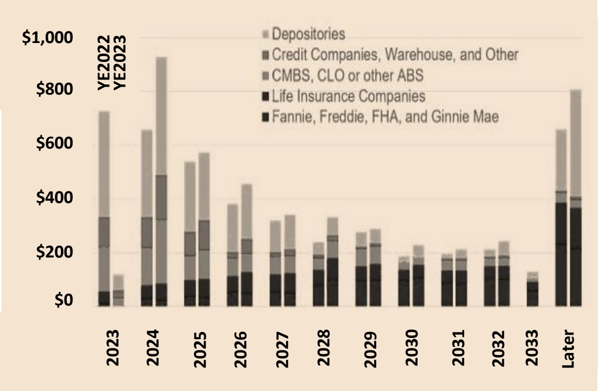
While banks are reducing their exposure to Commercial Real Estate Debt (CRED) due to regulatory requirements, alternative lenders such as insurance companies, foundations, pension funds, and private debt funds with significant liquidity are filling the gap, now covering 40% of the total credit volume in the commercial real estate market.

* 2 July 2016 to January 2020 Valvest US Bridge Loan Fund. February 2020 to present Valvest Steady Inome Fund. It should be noted that positive past performance is no guarantee of positive current performance or future performance. The performance data do not include commissions or fees for subscriptions and redemptions of shares. Investors should be aware that mutual fund prices may rise or fall and that past performance is not necessarily predictive of future performance.

Investment Opportunity

In the coming 12 to 24 months, we are facing a flood of maturing mortgage loans expected to reach $2 trillion.

Loan Maturities Pushed-up by 2023 Extensions ($billions)



Source: Mortgage Bankers Association

Elevated interest rates, combined with economic uncertainty, are particularly pressuring borrowers who cannot refinance their properties and must put them on the market. This is leading to significantly lower property prices in some cases.

What initially appears as a short-term challenge could prove to be an opportunity for liquid real estate investors. The stressed market conditions and the availability of attractively priced properties offer a unique opportunity for those familiar with the complex challenges of real estate financing. At Valvest, we specifically focus on defensive mortgage loans with low loan-to-value ratios to avoid defaults and provide solid returns to investors.

An example is the property we financed across from Apple's lucrative "The Cube" on Fifth Avenue. This street is one of the best retail corridors in New York, attracting 40,000 visitors daily. In 2015, the property was acquired by a Real Estate Equity Fund for $85 million and was equipped with a $70 million mortgage from a Chinese bank. The plan for repositioning failed due to inflated rent demands, leading to foreclosure.

At the auction in early January, a new buyer acquired the property for $26 million, and Valvest financed the purchase with a two-year, first-lien mortgage loan. We expect stabilization in the coming months and anticipate significant appreciation, paving the way for the payoff of our mortgage. In the meantime, this loan generates interest income of over 10%, protected by the security of a prime property in a top location, acquired at a substantial discount.

At Valvest, we focus on mortgage lending for properties with existing or expected net operating income (NOI) that covers the mortgage interest payments to protect us from defaults. If the NOI is insufficient to cover the interest, we require a interest reserve at the time of lending and hold it securely in an escrow account. In the current market environment, we seize the opportunity to assist experienced investors in purchasing prime properties at reduced prices. With the increasing number of mortgage defaults and rising financing costs, Valvest is well-positioned to finance properties worth $20 to $50 million, which has proven to be a highly attractive niche often overlooked by traditional lenders.

Senior Mortgage, Fifth Avenue, NY

Our approach has proven successful, and we can demonstrate an intact, liquid portfolio that achieves a return of over 10,00% with a low loan-to-value.

"There has never been a more exciting time to be active as a lender in the US real estate market."

The current situation in the US real estate market presents outstanding opportunities for lenders. The ongoing correction in the US commercial real estate market, which began 18 months ago due to rising interest rates, signals a significant turning point. The market has shifted from primarily focusing on capital gains to increasingly prioritizing sustainable income. Defensive investors are also following this transformation and adjusting their strategies by acting more as capital lenders and focusing on high security and stable returns.

Positioning oneself at the top of the capital structure to benefit from these market changes makes perfect sense. With the increased interest rates, the distribution of property income has significantly changed. In today's environment, it's not the real estate investor who receives the lion's share of the income, but rather the capital provider, and this is even with a first-lien security. This makes first-lien mortgages a very interesting investment case, especially considering that returns with conservative loan-to-values show minimal real estate price risk, as they are protected by the equity of the real estate investor.

Our proactive approach includes negotiating interest rate floors to reduce interest rate risks. This allows for the structuring of first-lien mortgages with high minimum coupons to continue profiting even with potential interest rate cuts. With the decline of traditional banks in the commercial mortgage market, alternative lenders have the opportunity to negotiate better terms, leading to low loan-to-value ratios and thus creating a high equity buffer. This buffer provides protection against potential losses even if property valuations decrease.

Investing in first-lien mortgages through Valvest's investment opportunities offers a stable source of income as an alternative to traditional investment instruments while also helping to reduce volatility in the overall portfolio.