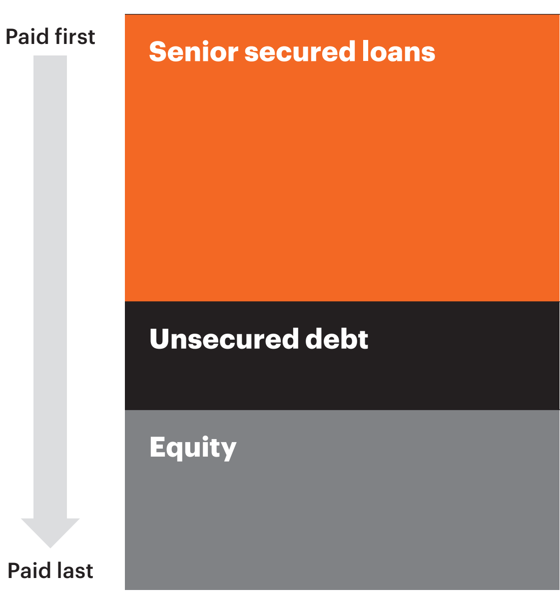
Investing in commercial real estate debt for income and stability

Key takeaways

- Commercial real estate (CRE) debt may provide an attractive level of income compared to many common fixed income investments.
- CRE debt may also serve as a source of portfolio stability and capital preservation since the investments are backed by the value of properties, (i.e., "hard" assets).
- Allocating to CRE debt may provide diversification and differentiated income, as the asset class is often missing from investors' portfolios.

Understanding the basis of CRE debt investing

Investors in commercial real estate debt serve as lenders to property owners to help purchase, renovate or repurpose a property. An investor's return is largely driven by the interest income paid on the loan (or other form of debt) and retains a degree of insulation. That is, CRE debt investors are paid ahead of property owners, which is important if there is a change in the amount of income a property generates or the value of a property (see charts on back).



- **First to be paid from rental income**
- Returns primarily driven by interest income

- **Paid after senior secured loans**
- Returns primarily driven by interest income

- **Last to be paid**
- Returns based on rental income and changes in property value

Continued on back

A potential source of income and portfolio stability

CRE debt investors are entitled to receive the income a property generates ahead of the property owner. This priority of payment may help protect the level of income CRE debt investors receive, which is especially valuable during market downturns.

After operating expenses are paid (i.e., taxes, insurance, maintenance), commercial real estate debt investors are the next to be paid from rental income. Any excess income then flows to the property owner.

Chart 1 illustrates how a CRE debt investor's income may remain unchanged despite a 15% decline in annual rental income while the excess income declines significantly for the property owner.

CHART 1: IMPACT OF CHANGE IN RENTAL INCOME

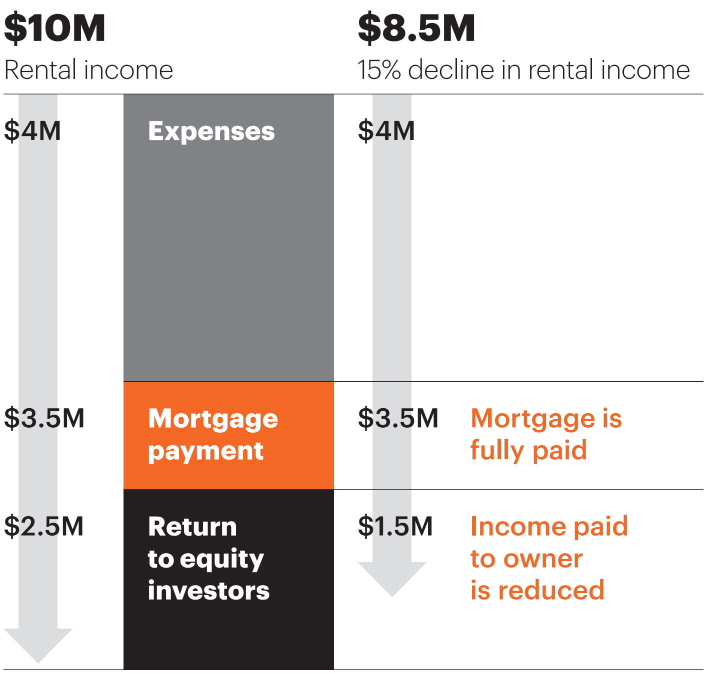
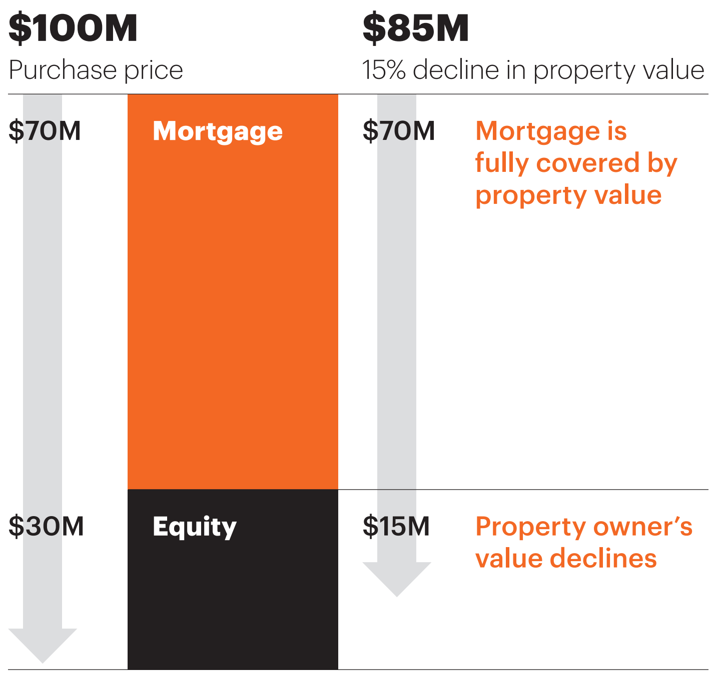


CHART 2: IMPACT OF CHANGE IN PROPERTY VALUE



CRE lenders typically lend against a portion of a property's value, which helps provide a cushion against losses if property values decline. Chart 2 illustrates how the cushion provided by collateral in the form of a hard real estate asset may help protect principal. Our hypothetical shows that even if the property value declines 15%, the reduced value fully covers the mortgage while the property owner's equity value is cut in half.

To learn more about investing in CRE debt
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