RESCUE CAPITAL: HELPING OPERATORS MANAGE THROUGH VOLATILITY

LBX investments

MARKET COMMENTARY | APRIL 7, 2021

Providing Expedited Capital Can Turn Tough Situations Into A Win-Win

Will Rescue Opportunities Emerge More Consistently, However?

OVERVIEW

In February, LBX provided a $6.75 million first lien mortgage secured by an 85,565 SF neighborhood shopping center in suburban Atlanta. The "East West" loan (which costs the borrower 9% annually) was a win-win: it provided time-sensitive liquidity to an experienced operator secured by a solid piece of real estate. We enabled the operator to refinance their existing loan while LBX was able to participate in the economics of a strong retail location at very compelling metrics.

First, our basis is ultra-low at less than $80/SF (less than half of estimated replacement cost). We do not plan on repossessing the property but, at that basis, our downside scenario would present significant upside potential should we end up owning the asset. Second, we have excellent debt service coverage: our LTV was less than 50% of appraised stabilized value, and our debt yield (NOI/loan amount) was ~14%, very high for a property of this quality. This sort of position offers us financial flexibility – should the borrower underperform at the property level, we will still maintain significant cushion. Finally, we conservatively leveraged our position with low-cost bank debt, significantly boosting our 9% return while still maintaining a very low level of risk.

The opportunity came about because the sponsor was in a bind. Their previous lender had sold their note during the worst months of the pandemic and the sponsor needed to refinance the asset quickly, or risk losing it. LBX's partners' experience operating as both shopping center owners and institutional lenders enabled us to fully assess the risks of the transaction and act quickly to provide capital.

METRICS: EAST WEST LOAN

TERM	DETAILS
Loan Size	$6.75 Million
Location	Austell, GA (Atlanta MSA)
LTV	<50%
Rate To Borrower	9%

Source: LBX Investments

RESCUE CAPITAL, DEFINED

The East West loan was an example of "rescue capital," a term that reflects situations expected to emerge from distress (in this case, caused by the COVID-19 pandemic). In textbook examples, rescue capital providers offer short-term financing solutions utilizing varying structures including senior debt, preferred equity, mezzanine debt, or even fresh joint venture equity in order to facilitate solutions for owners that have encountered some sort of challenge. The opportunity for groups like LBX is clear: we can generate attractive risk-adjusted returns, often with high current yields, for providing this type of liquidity to capable operators secured by quality pieces of real estate. Should we need to step in to take a property over, we can do so at a basis at which we would be comfortable owning an asset. This basis is generally far less than current market value. Our Managing Partners' professional backgrounds as both lenders/managers of fixed income investments and owners/operators of real estate enables this type of strategy.

Rescue capital is generally expensive for the borrower/owner. Although deal terms and structure will vary on a case-by-case basis, return requirements are typically comparable to value-add equity investments while control provisions, such as key decision-making rights and preferential treatment for the rescue capital are common. This can create a very attractive risk-return ratio with equity subordination and debt features but equity-like returns.

East West Shopping Center in Austell, GA

Source: LBX Investments

SITUATIONS THAT COULD CALL FOR RESCUE CAPITAL

- An asset's value has declined due to extraneous forces (i.e., COVID impact), their financing is coming due and their equity has been meaningfully impacted by the market decline. They need capital to maintain the asset through an eventual recovery, when property income and values are expected to rebound.
- An operator has a solid project with a good business plan that has been upended and needs capital in order to reach completion.
- An operator needs capital in order to complete an acquisition, but due to capital markets dynamics, the sponsor has a gap in their capital stack and need additional sources to fund the transaction.

INVESTOR CONTACTS

Heath Binder | SVP, Investor Relations | (646) 824-9394 | heath@lbxinvestments.com

Philip Block | Managing Partner | (917) 657-2542 | phil@lbxinvestments.com

Rob Levy | Managing Partner | (201) 741-8441 | rob@lbxinvestments.com

RESCUE CAPITAL: HELPING OPERATORS MANAGE THROUGH VOLATILITY

MARKET COMMENTARY

APRIL 7, 2021

WHERE'S THE OPPORTUNITY?

Today, there is significant liquidity in the market for rescue capital, but this is accompanied by uncertainty over how this capital will be deployed. Considerable funds are being raised for opportunistic and/or rescue capital investments at an institutional level by industry giants like Starwood, Blackstone, and Oaktree. These firms have amassed billions of dollars since the onset of COVID. Even so, a quick examination of industry trends suggests that for smaller investors like LBX, there may still be a mismatch between supply (opportunities requiring rescue capital) and demand (capital), at least in the short-term.

First, distress has been largely held off by factors including lender forbearance and government stimulus. When the COVID-19 pandemic first hit in early 2020, investors had widespread expectations that opportunities would present themselves in due course. The government acted quickly to mitigate distress, however, by pumping trillions of dollars into the economy and encouraging lenders to provide flexibility to their borrowers. With this, no wave of distress emerged. This was the case even in retail and hospitality, the two sectors that suffered the most from an operational and value level due to the pandemic.

Second, transaction volume has been muted compared to before the pandemic across all sectors. The most obvious place to look for investments is the hospitality sector which, per Real Capital Analytics, is the only sector that has seen a sharp increase in distressed sales as a percentage of sector volume: "Between March of 2020 and February of 2021, 8% of hotel sales involved a distressed asset." However, even in this sector, transaction levels remain muted. During this 12-month period, "Only \$10.6 billion of hotels traded, as compared to \$36.6 billion in the prior 12-month period."

Third, outside of the retail sector, pricing has generally gone up. RCA's National All-Property Index rose 0.9% month-over-month in February 2021 and only retail – which saw a 1.4% year-over-year negative change – saw a pricing decline. Multifamily and industrial prices have risen 7.2% and 8.1% year-over-year, respectively, and these two sectors have accounted for 60% of deal volume across the five core asset classes. In the case of industrial assets, investors remain bullish on logistics and cold storage demand, but multifamily prices have continued to rise primarily because of the low interest rate environment and perceived safety of the sector.

GOING FORWARD

LBX can be patient while we assess the rescue capital landscape. We believe that opportunities will continue to materialize despite ample liquidity in the market and weaker transaction volume. As a company, we have developed a robust network of middle market relationships around the country to source opportunities like East West. At press time, for instance, we are working on a preferred equity investment in a multifamily project in Houston. Some broader market conditions also bode well for our ability to provide rescue capital going forward.

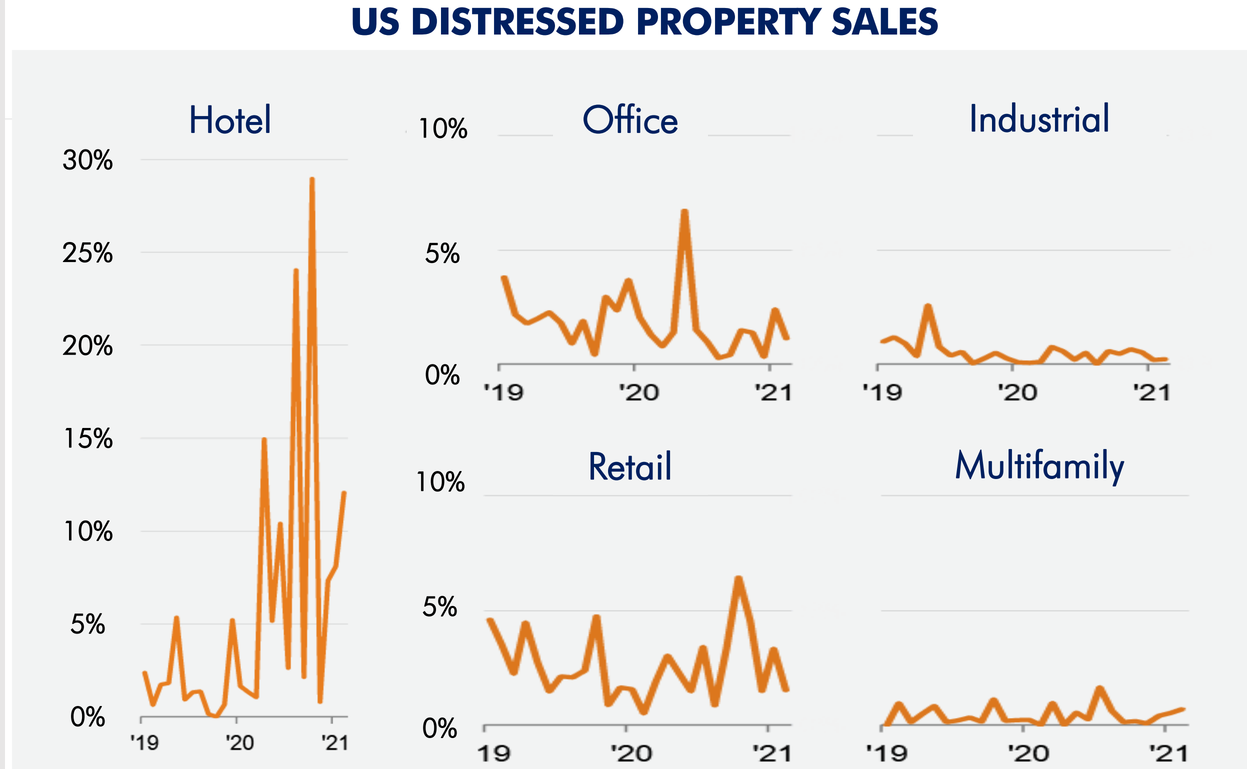
First, the financing market remains challenging for specific segments with different real estate sectors, such as non-grocery anchored retail. Owners of those deals that have bridge loans coming due, for instance, can get far less leverage (~60% LTV) in today's climate than they could before the pandemic and the universe of lenders has thinned out dramatically. Second, there has been some evidence – particularly with interest rates beginning to rise from record lows – that senior lenders are unwilling to stretch valuations much further in hot sectors such as multifamily. We believe there may be opportunities to enter multifamily investments at attractive price points by using structures such as preferred equity.

TOP 10 REAL ESTATE FUNDS IN MARKET

Fund	Manager	Target Size ($bn)	Fund Strategy	Region
Starwood Distressed Opportunity Fund XII Global	Starwood Capital Group	7.5	Opportunistic	Multi-regional
CIM Opportunity Zone Fund	CIM Group	5.0	Opportunistic	North America
Oaktree Real Estate Opportunities Fund VII	Oaktree Capital Mgmt	3.5	Opportunistic	Multi-regional
Fortress Credit Opportunities Fund V Expansion	Fortress Investment Group	3.0	Opportunistic	Multi-regional
KKR Real Estate Partners Americas III	KKR	3.0	Opportunistic	North America
PIMCO Corporate Opportunities Fund III	PIMCO	3.0	Debt	North America
Oaktree Real Estate Debt Fund III	Oaktree Capital Mgmt	2.75	Debt	Multi-regional
CIM Fund IX	CIM Group	2.5	Opportunistic	North America
AIG US Real Estate Fund III	AIG Global Real Estate	2.0	Value-Add	North America
AllianceBernstein Commercial Real Estate Debt Fund IV	Alliance Bernstein	2.0	Mezzanine / Debt	North America

Source: PERE

US DISTRESSED PROPERTY SALES



Source: Real Capital Analytics: Sales out of distress as share of total sector monthly sales through February 2021.