

Principal Real Estate

# The good, the bad, and the misunderstood

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Distressed Real Estate Forum

**RICH HILL, GLOBAL HEAD OF RESEARCH & STRATEGY**

# Are both side of the debate right and wrong?

CRE valuations may have turned the corner while distress is still rising

**Puppy dogs & rainbows**



VS.

**Tsunami of debt**

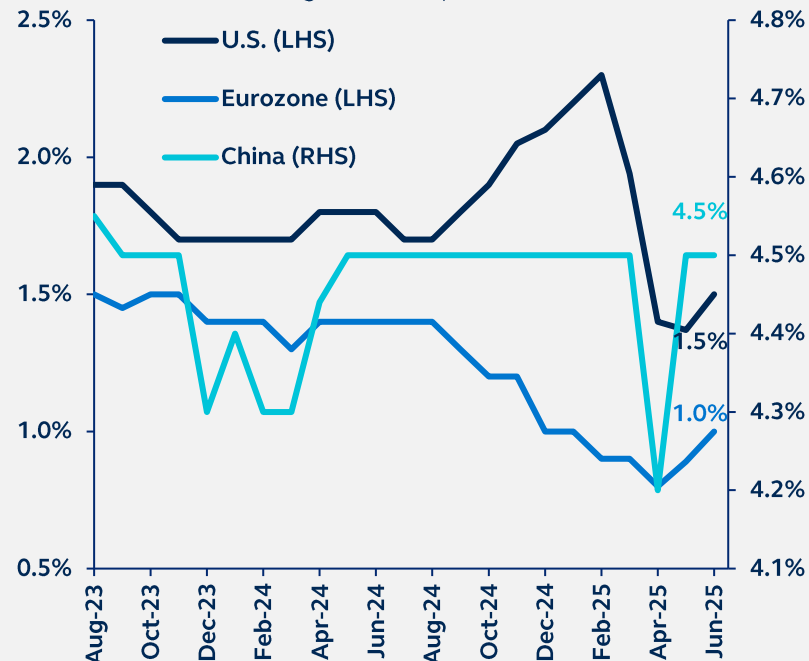


# A series of global shocks test long-term trends

The U.S. exceptionalism narrative has sustained a severe blow

## GDP forecasts

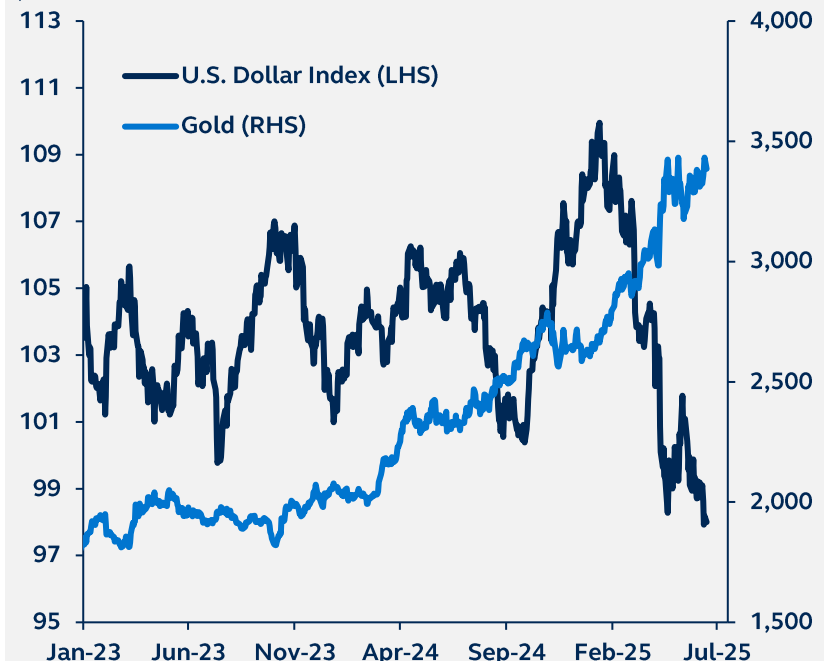
Consensus 2025 real GDP growth forecasts for U.S., Eurozone and China, August 2023–present



Source: Bloomberg, Principal Asset Management. Data as of June 30, 2025

## U.S. Dollar and Gold

U.S. Dollar Index spot rate vs. Gold spot price, January 2023–present

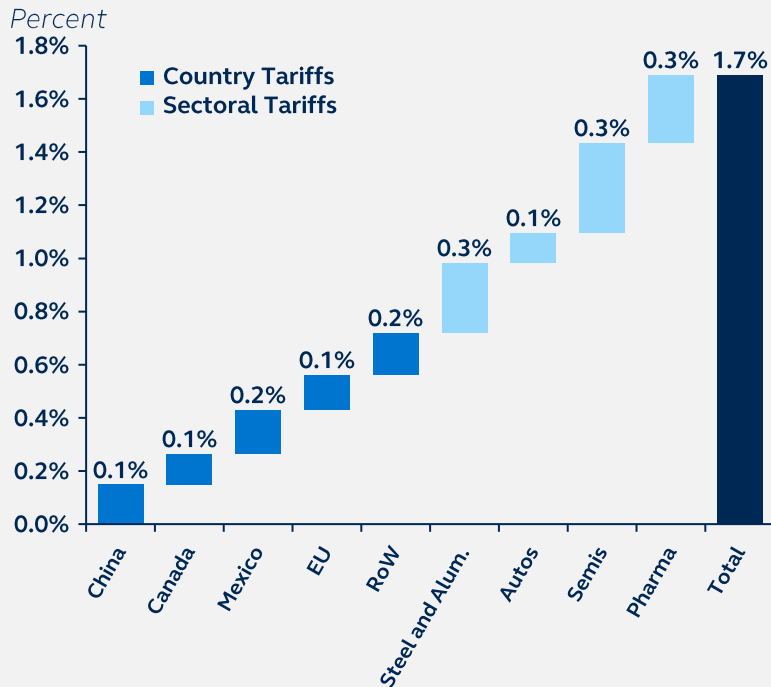


Source: Bloomberg, Principal Asset Management. Gold spot price quoted as U.S. dollars per troy ounce. Data as of June 30, 2025.

# Tariffs: A (less) punishing picture for U.S. growth

Trade uncertainty likely to remain high; tariffs ultimately to settle at around 17%

## End-2025 baseline tariff scenario: negative impact of tariff increases on U.S. GDP

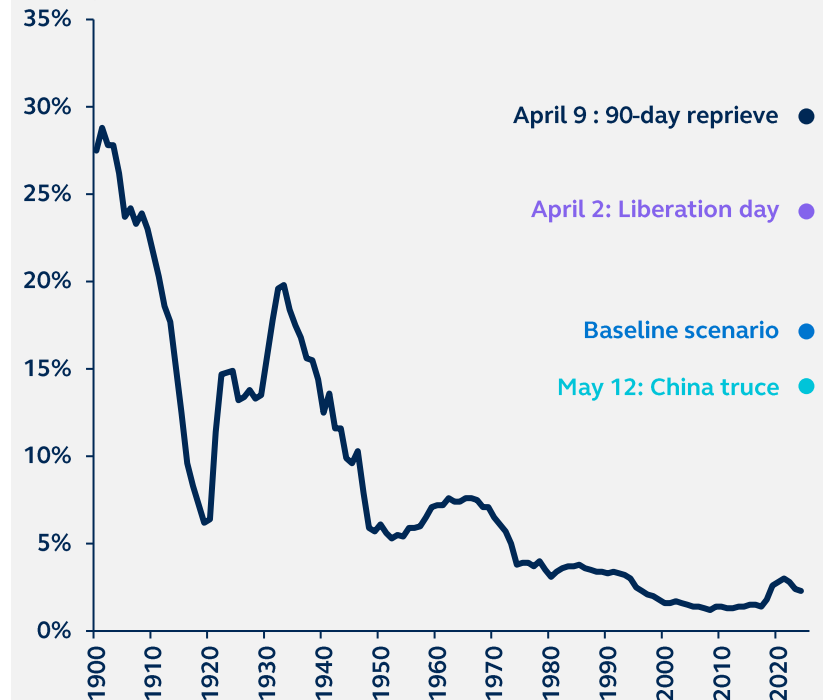


Baseline assumes: Global 10% reciprocal tariffs maintained; EU 10% reciprocal tariffs maintained; Current status quo for China, Canada, and Mexico, and existing exemptions are maintained; 25% sectoral tariffs on semis, pharmaceuticals, and autos, 50% sectoral tariffs on steel and aluminum.

Source: International Monetary Fund, World Trade Organization, Census Bureau, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

## U.S. average effective tariff rate

1900-present



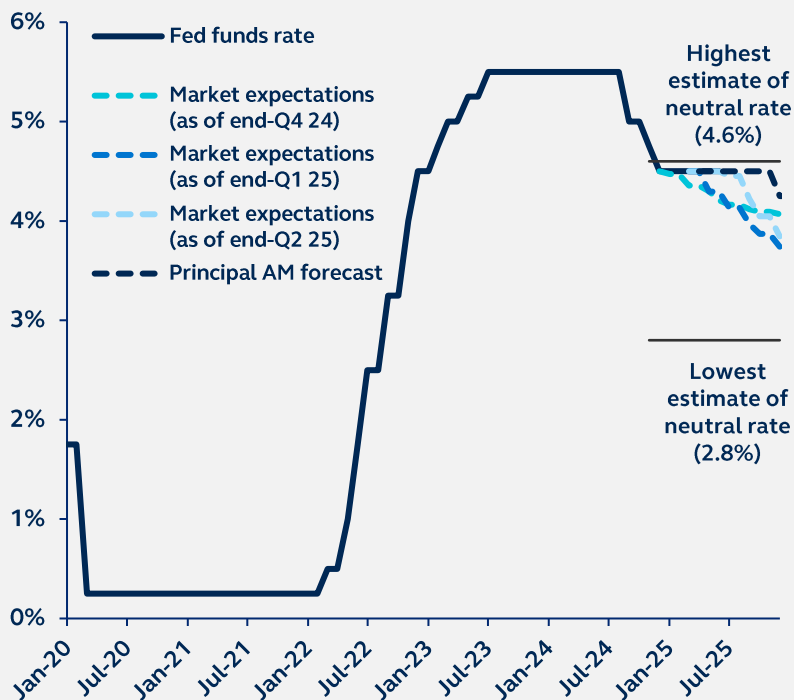
Source: United States International Trade Commission, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

# Both monetary and fiscal policy play a tough game

## Polymakers are navigating a narrow path

### Federal Reserve policy rate path

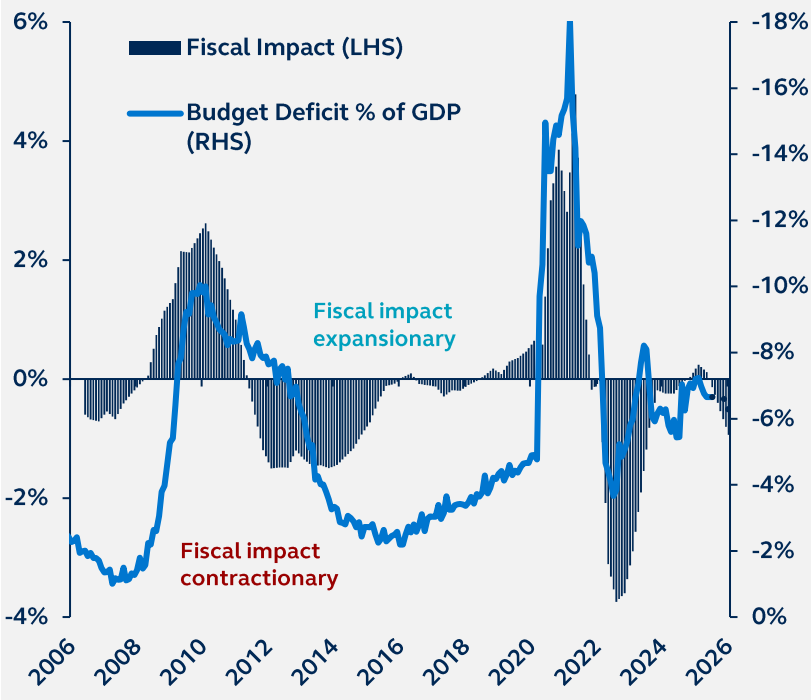
Fed funds rate and projections, 2020–present



Source: Federal Reserve, Bloomberg, Principal Asset Management. Highest and lowest neutral rate estimate levels are derived from a wide range of Wall Street analysts and models. Data as of June 30, 2025.

### Fiscal impact vs. budget deficit

Percentage of GDP, 2006–present



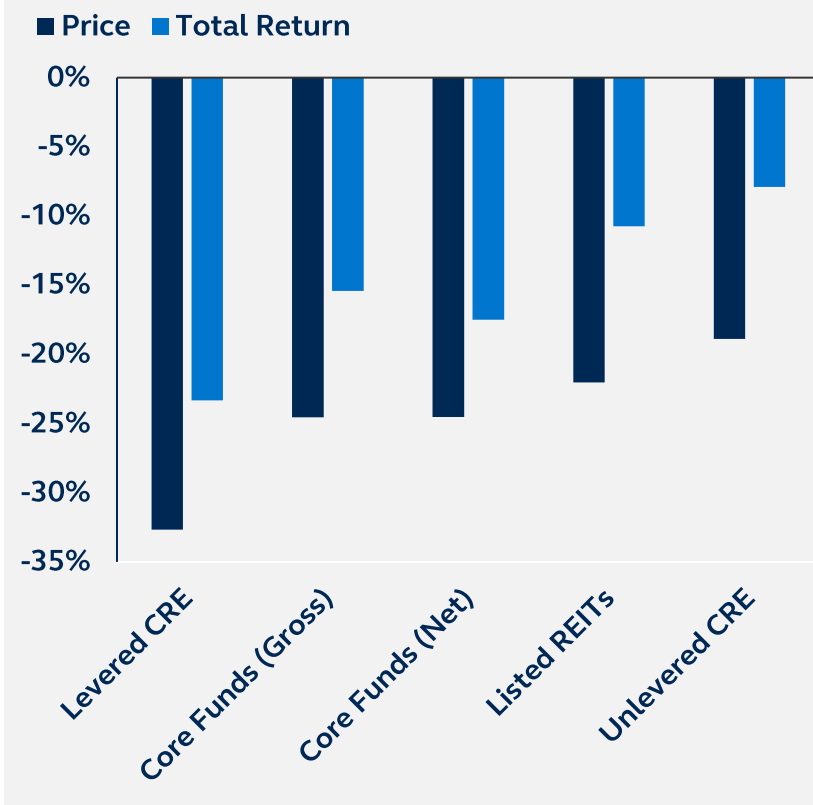
Note: The Fiscal Impact Measure, sourced from Brookings, shows how much government tax and spending policy adds to or subtracts from overall economic growth.

Source: Brookings, Bloomberg, Principal Asset Management. Data as of June 30, 2025.

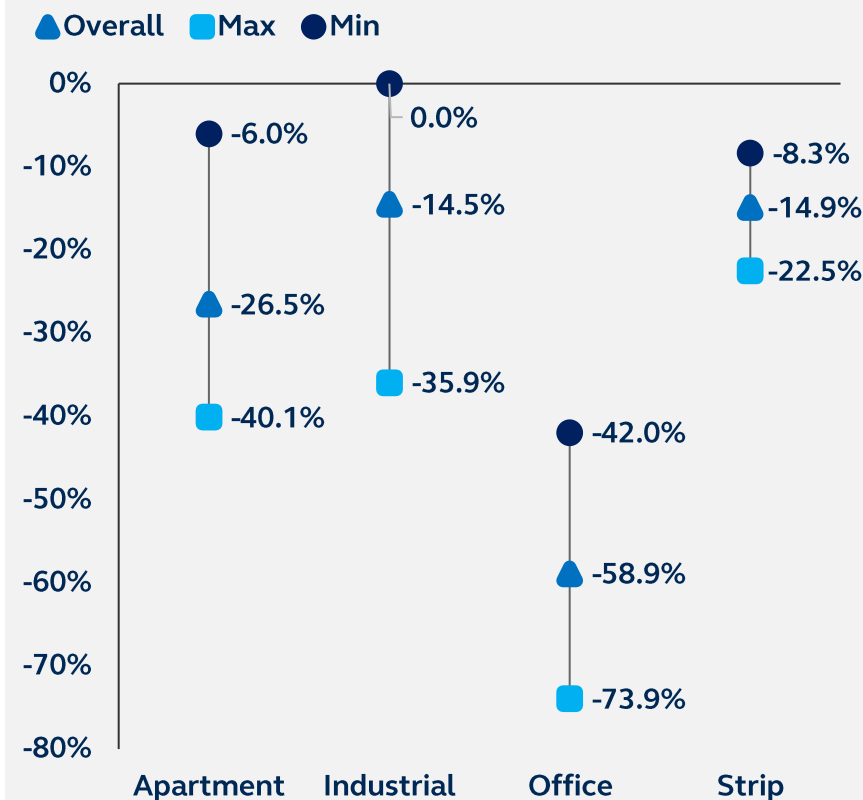
# How much are prices down?

It depends on your perspective

## Snapshot of peak-to-current returns



## Price declines across top 50 markets



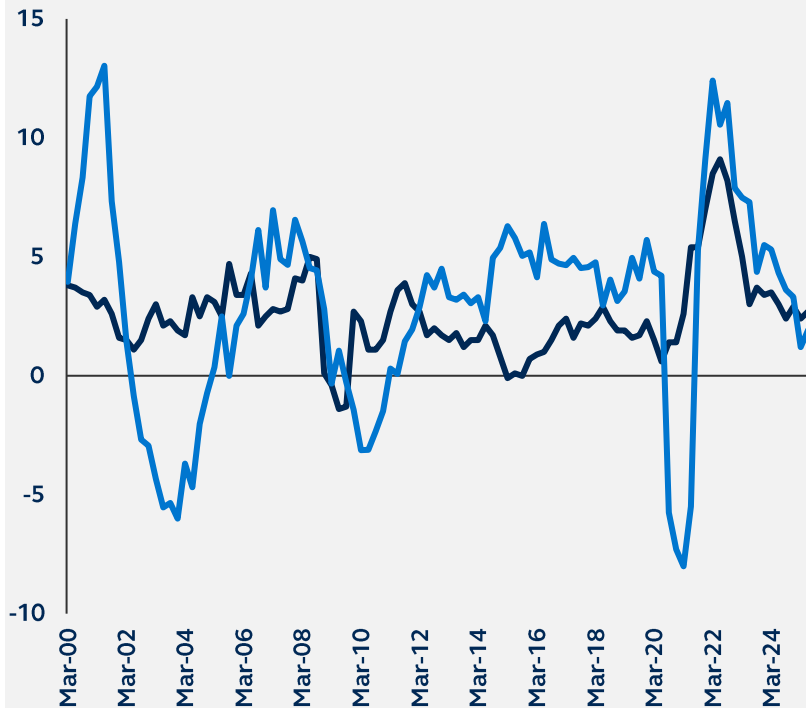
Source: NCREIF, Bloomberg, Green Street, Principal Real Estate, ODCE returns are as of 30 June 2025 (net of fees, local currency basis) and U.S. Listed REIT returns, as represented by FTSE NAREIT All Equity Index, are as of 30 June 2025. Indices are unmanaged and do not take into account fees, expenses, and transaction costs and it is not possible to invest in an index.

# CRE is historically a hedge against inflation

But stagflation (rising rates & slowing growth) threw a wrench into the equation

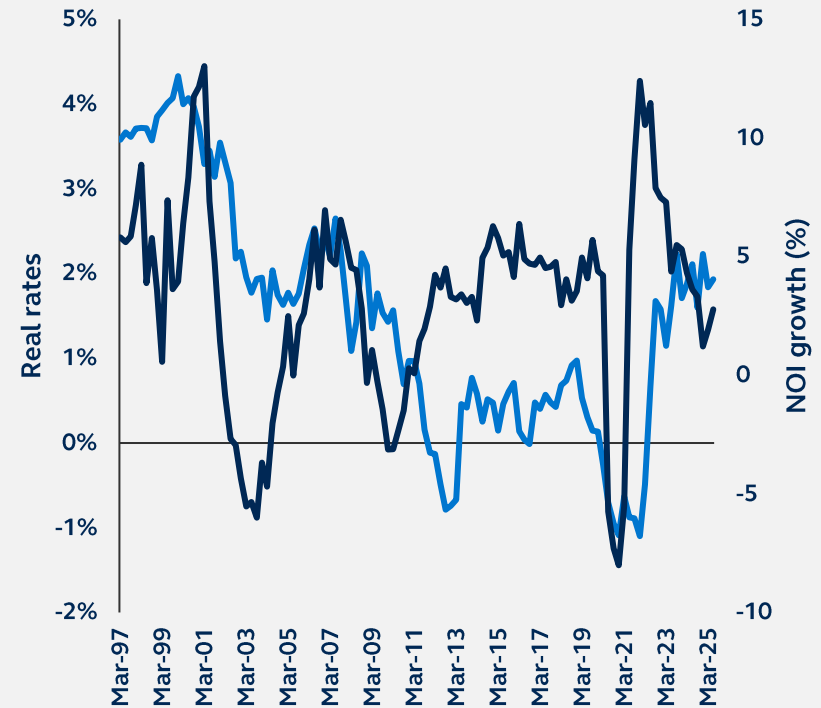
**Inflation vs NOI growth (%)**

— Inflation — NOI Growth



**Real rates vs NOI growth (%)**

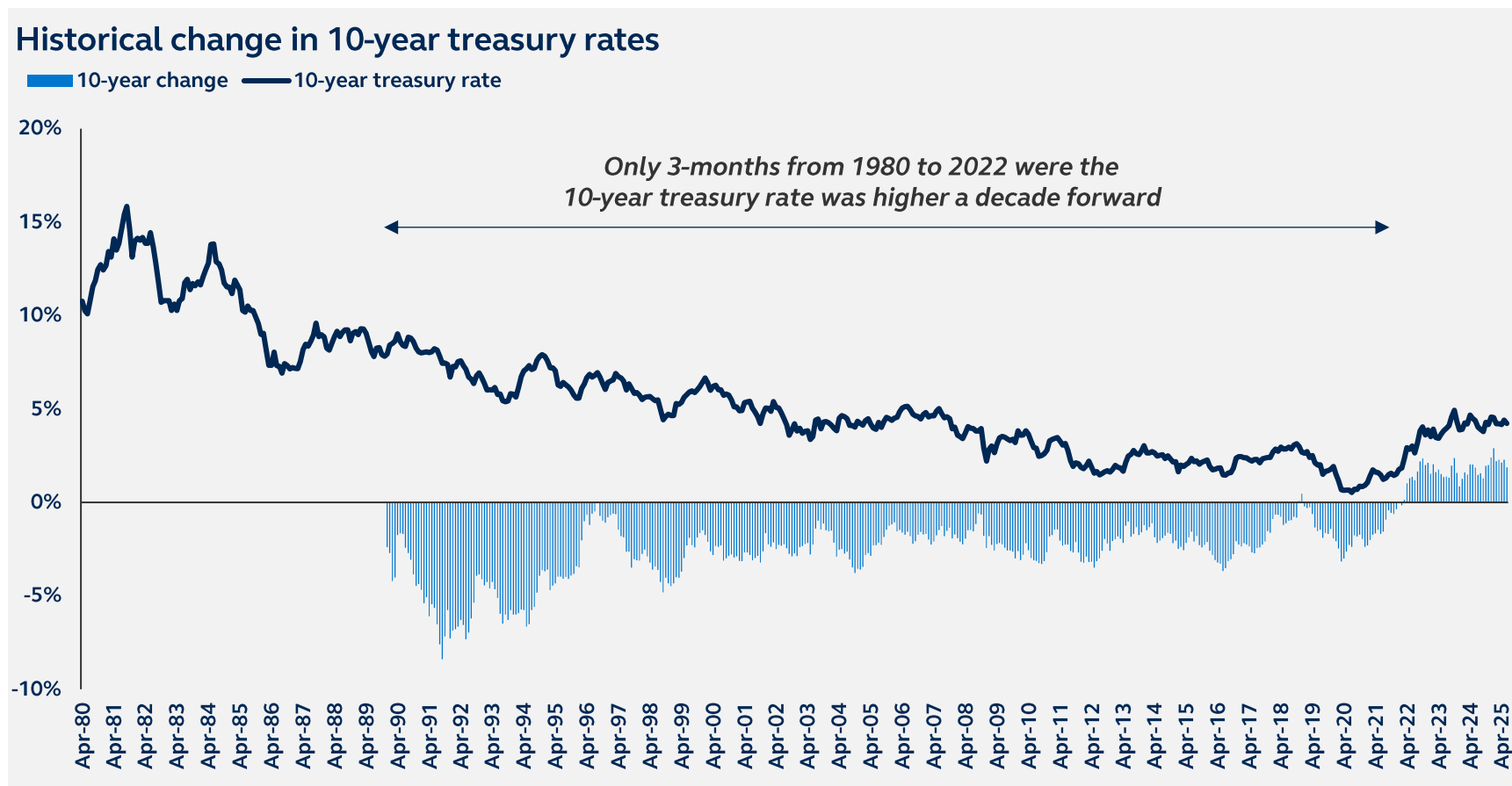
— Real Rates — NOI Growth



Source: Federal Reserve, NCREIF, Principal Real Estate, as of 30 June 2025

# How big was the move in rates?

Secular decline in 10-year treasury rates comes to a sudden halt

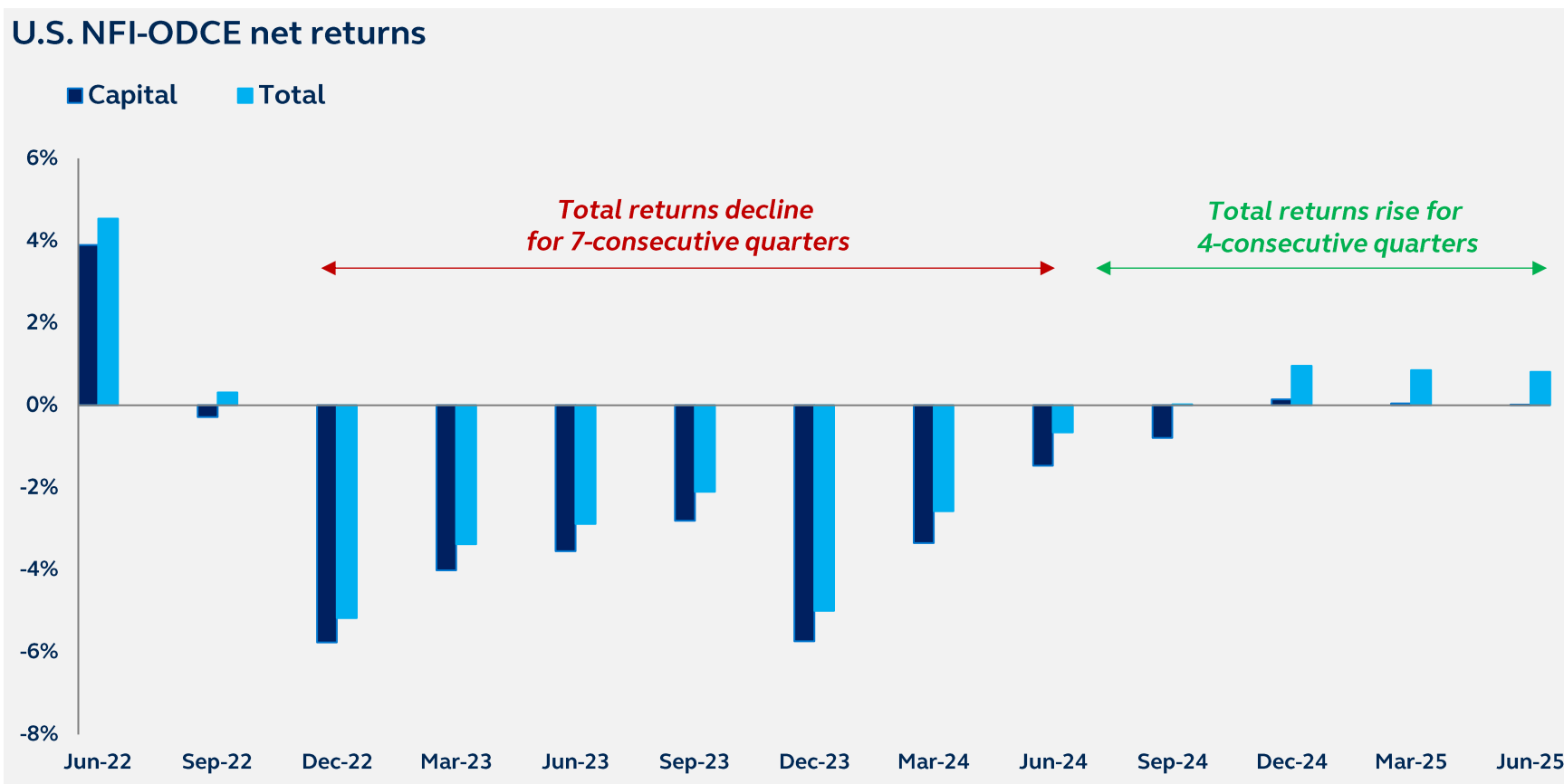


Source: Federal Reserve, NCREIF, Principal Real Estate, as of 31 July 2025



# U.S. CRE prices appear to have turned the corner

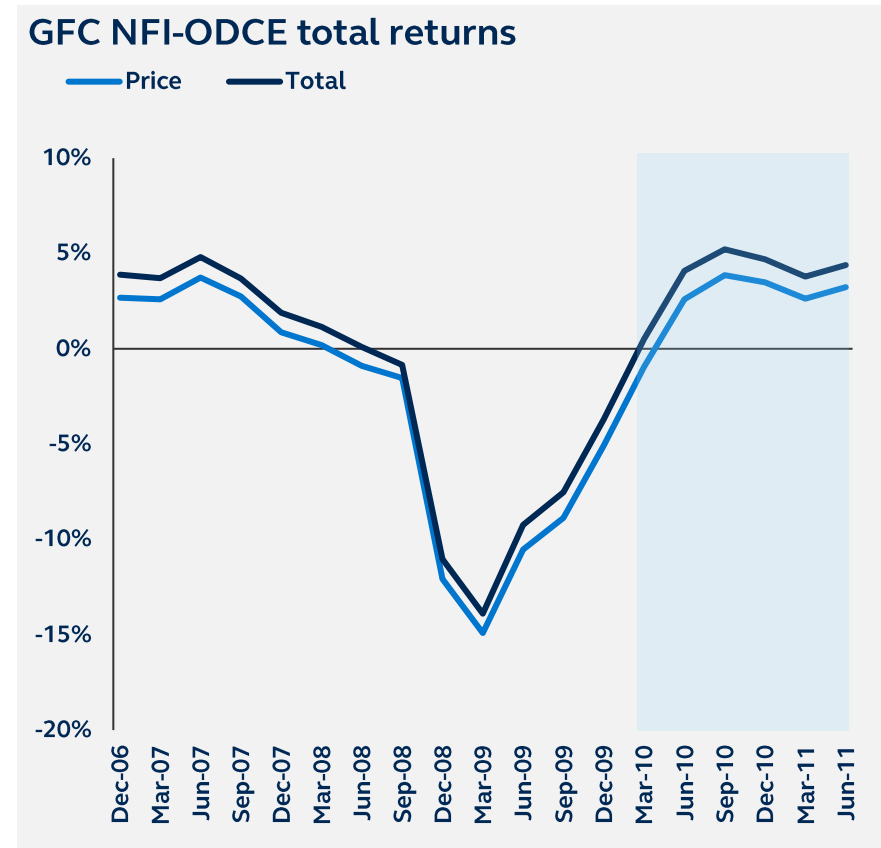
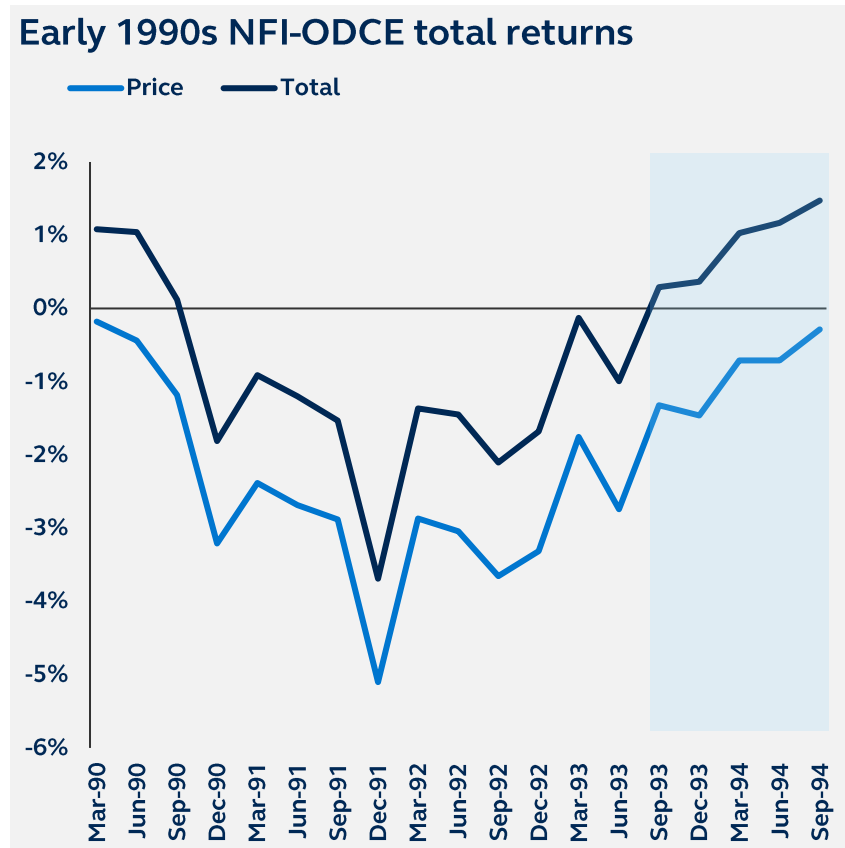
We project +/-5% total returns in 2025 driven primarily by income



Source: NCREIF, Principal Real Estate, as of 30 June 2025. Indices are unmanaged and do not take into account fees, expenses, and transaction costs and it is not possible to invest in an index.

# Objects in motion historically remain in motion

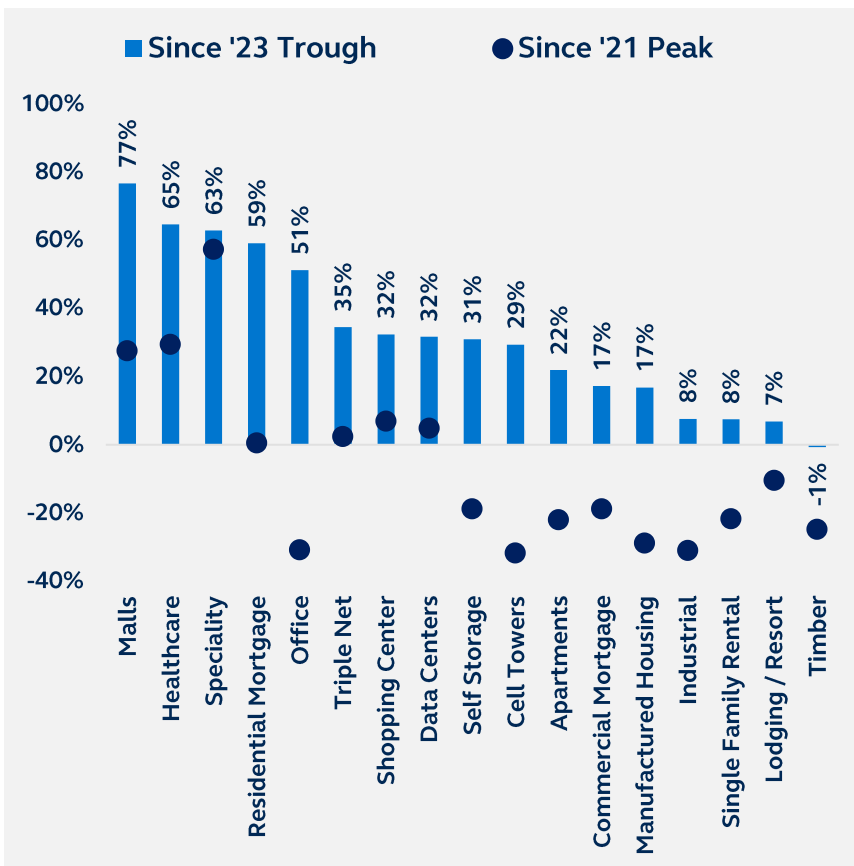
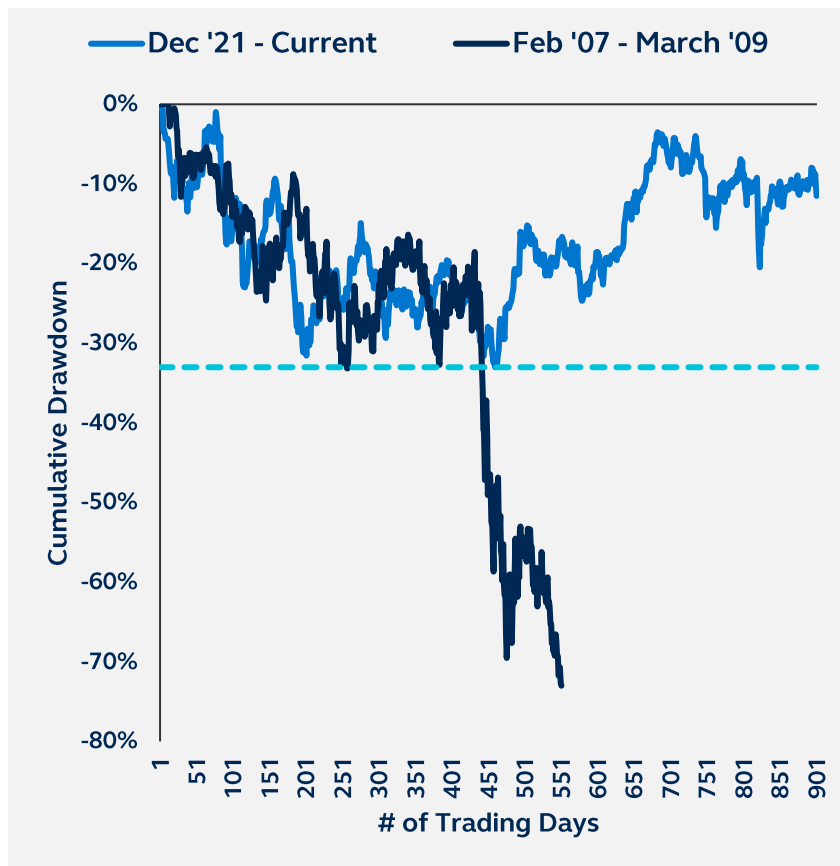
History shows that when total returns turn positive, they remain positive



Source: NCREIF, Principal Real Estate, as of 31 March 2025. Indices are unmanaged and do not take into account fees, expenses, and transaction costs and it is not possible to invest in an index.

# Listed REITs are leading indicators

They've rebounded +30% since their October '23 lows



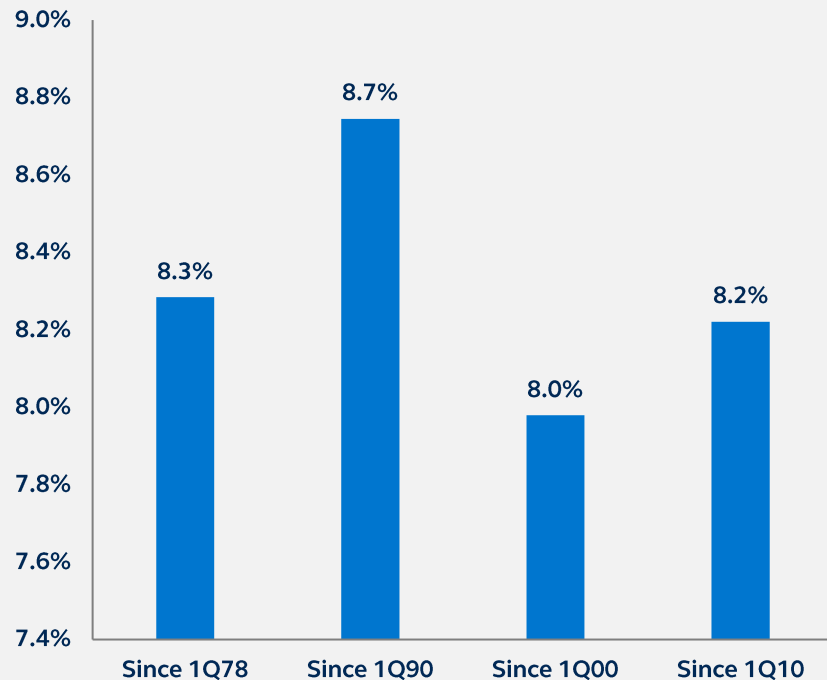
Source: Bloomberg, Principal Real Estate, as of 30 June 2025. Listed REITs represented by FTSE NAREIT All Equity Index. Indices are unmanaged and do not take into account fees, expenses, and transaction costs and it is not possible to invest in an index.

# Historical CRE Private Equity Returns

Rolling average 10-year CAGRs

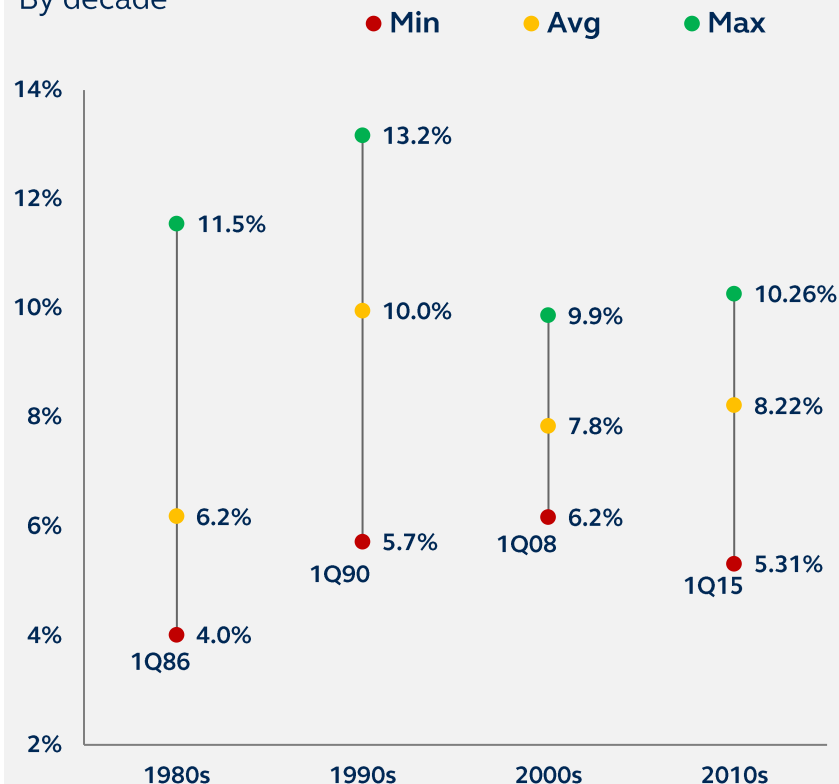
## Average rolling annual 10-Year return

At various start dates



## Average rolling annual 10-Year return

By decade

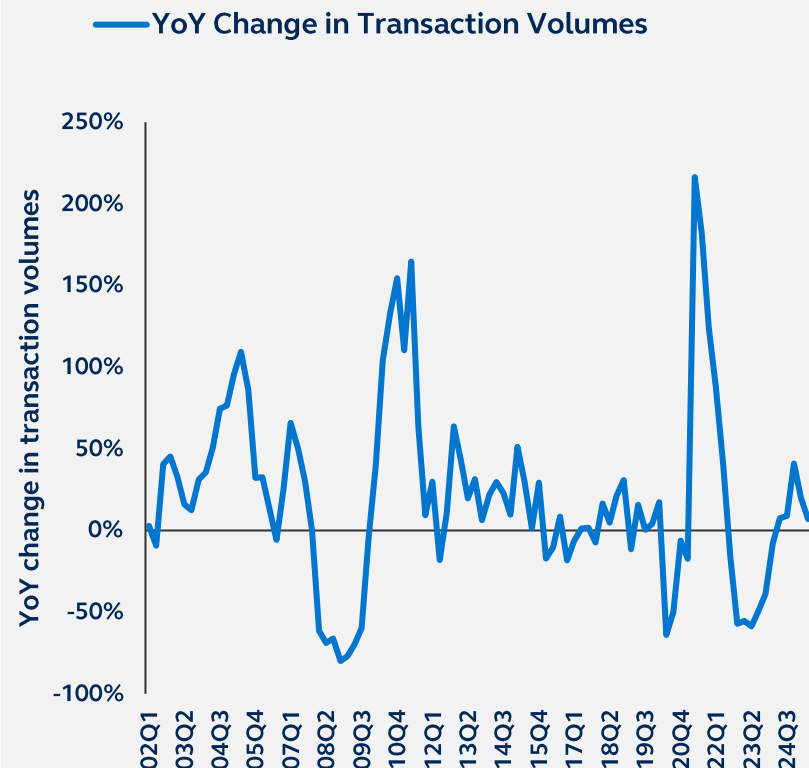


Source: NCREIF, Principal Real Estate, as of 31 March 2025.

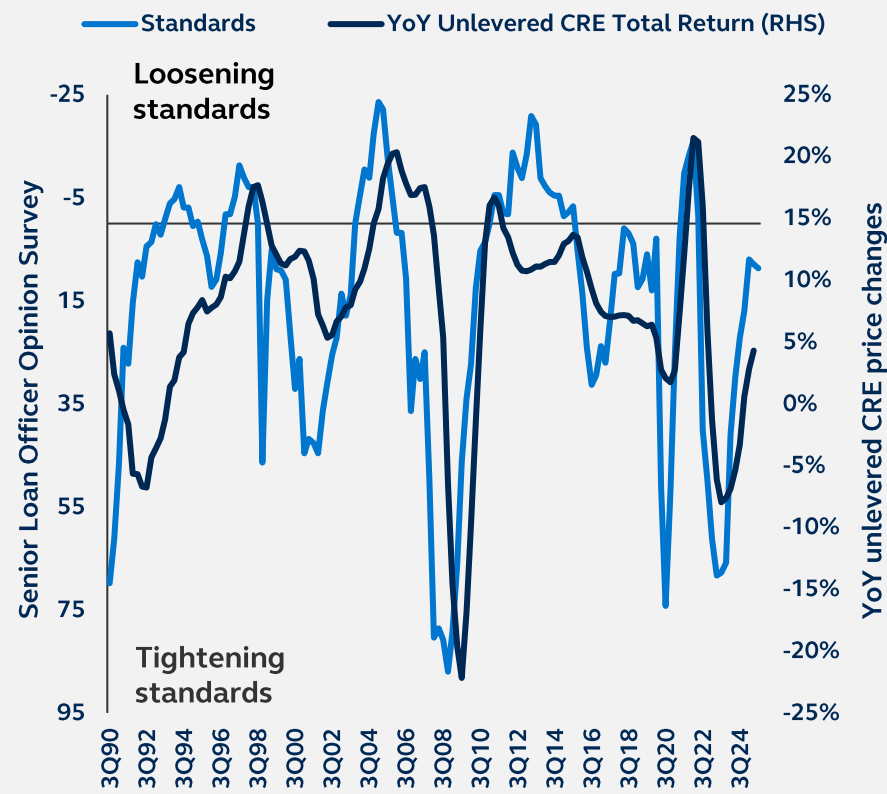
# CRE capital market resilient in 2Q25

Transactions rose and lending conditions tighten slightly

## Quarterly transaction volume change



## Senior Loan Office Opinion Survey

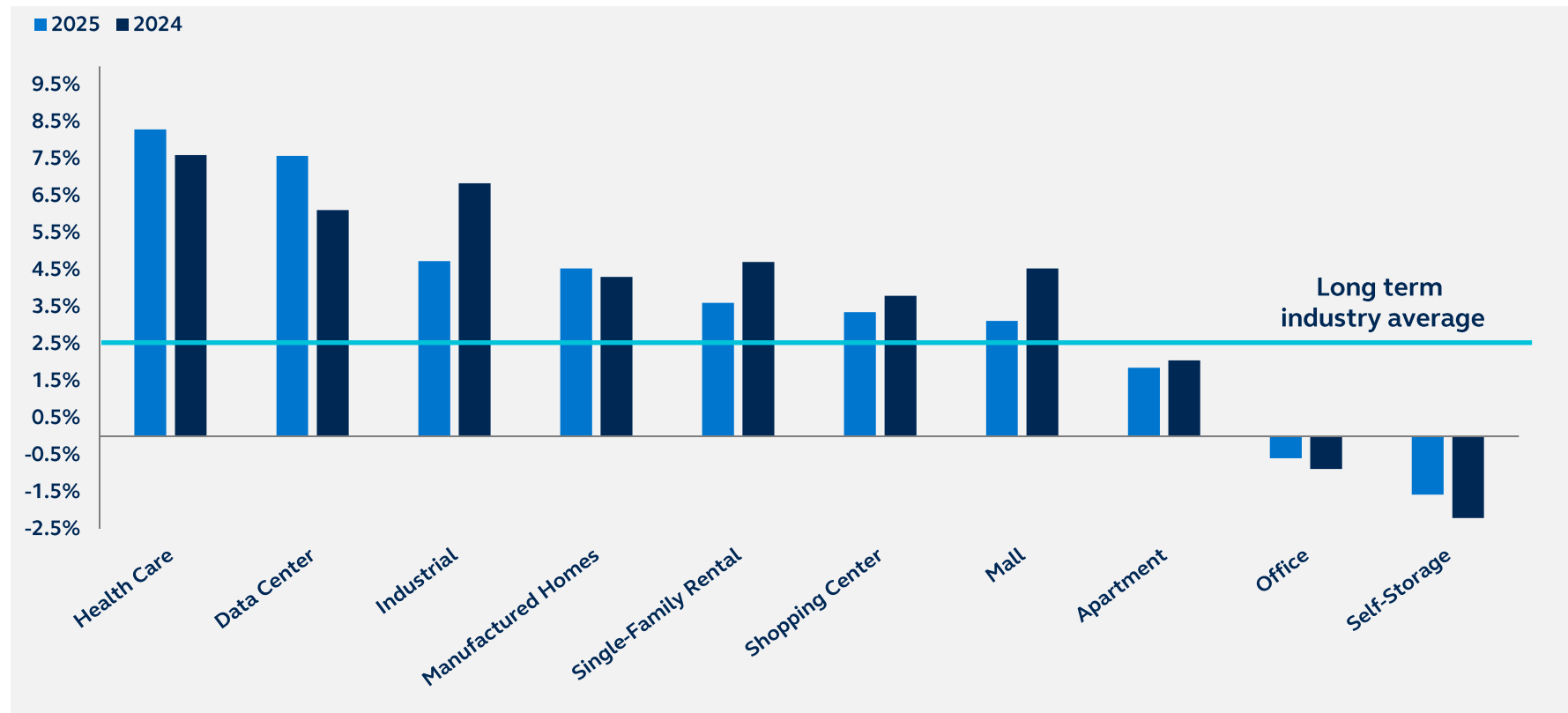


Source: RCA, NCREIF, Principal Real Estate, as of 30 June 2025

# NOI growth is solid for most property types

Office is the only property type facing secular headwinds

Same property NOI growth by property sector  
As of 2Q25

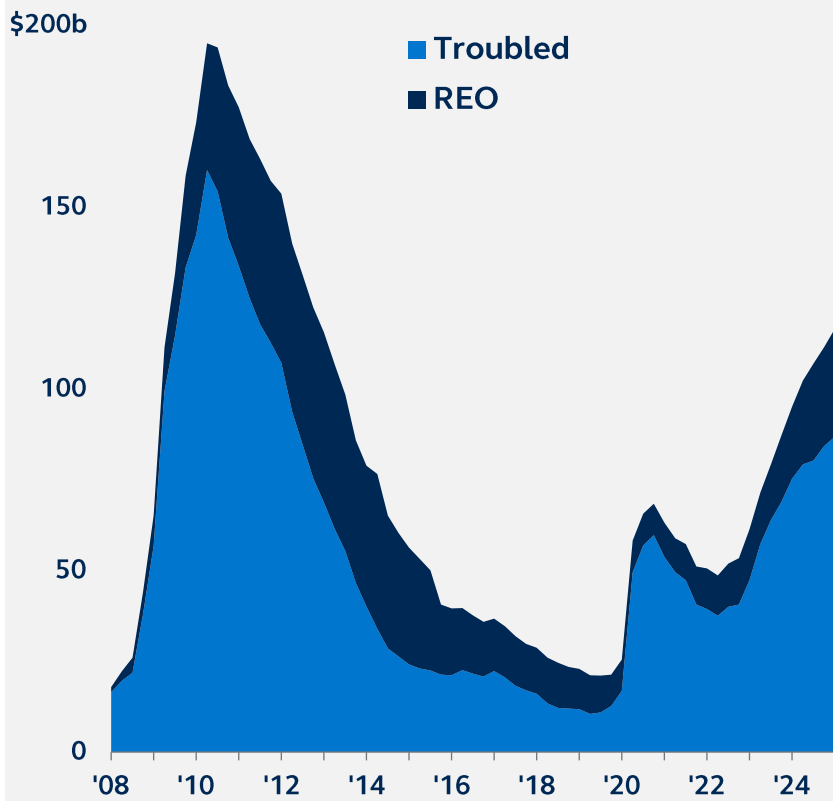


Source: NCREIF, Principal Real Estate, as of 30 June 2025.

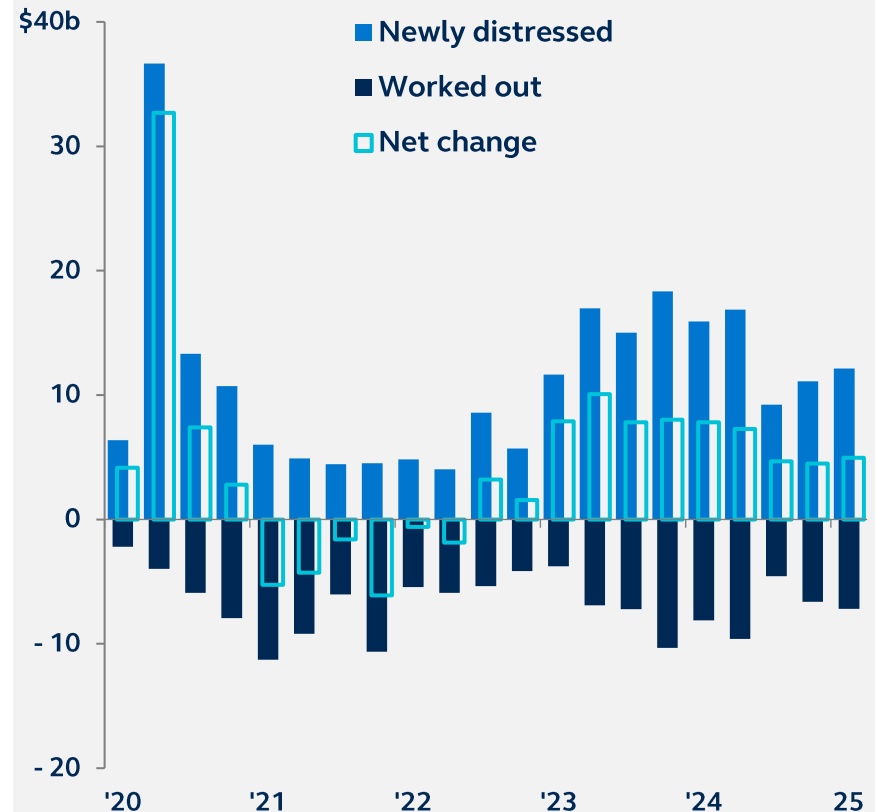
# Distress stands at \$116bn, highest level since 1Q13

It rose at an accelerating rate in 1Q25

## Historical cumulative distress



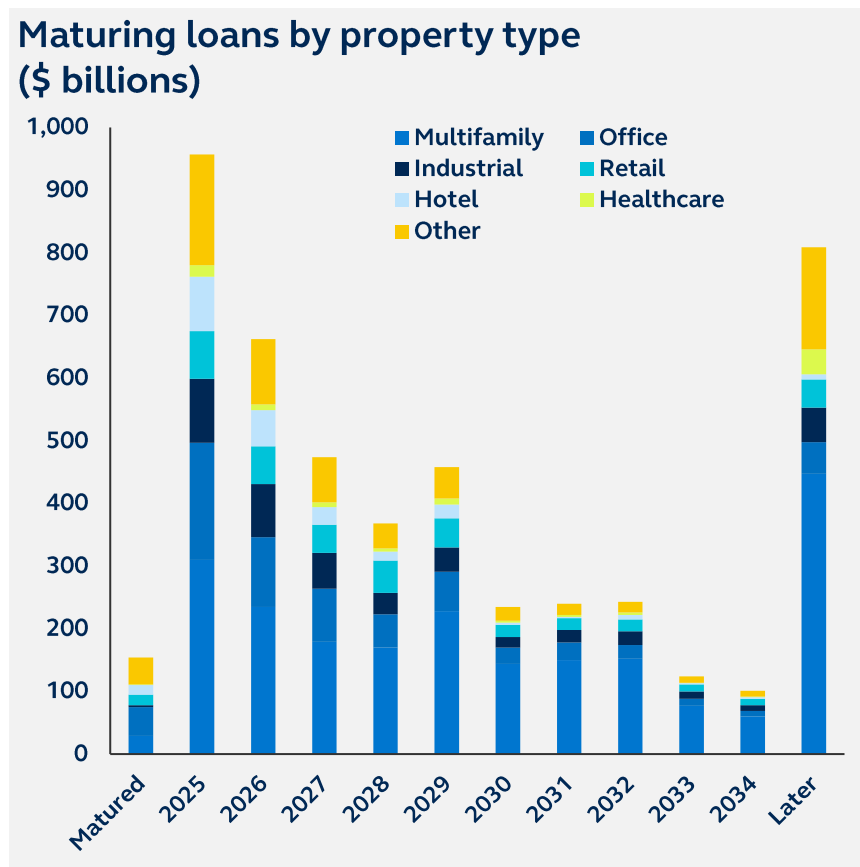
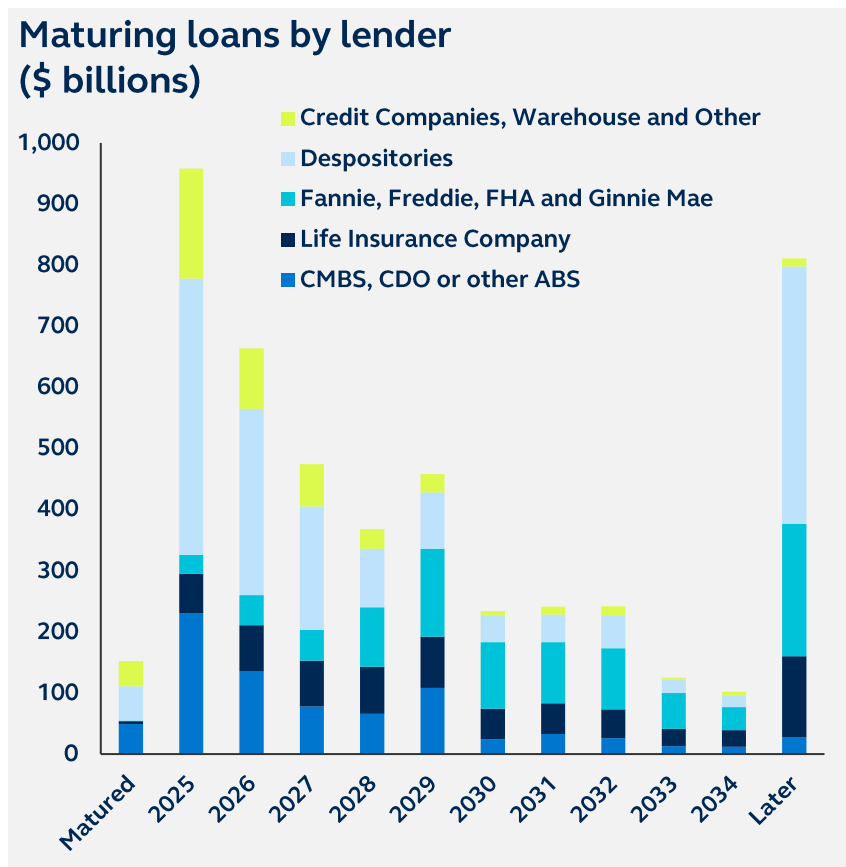
## Additions and reductions to distress



Source: RCA, Principal Real Estate, as of 30 March 2025

# Forthcoming loan maturities are a potential catalyst

This provides an opportunity for non-bank lenders



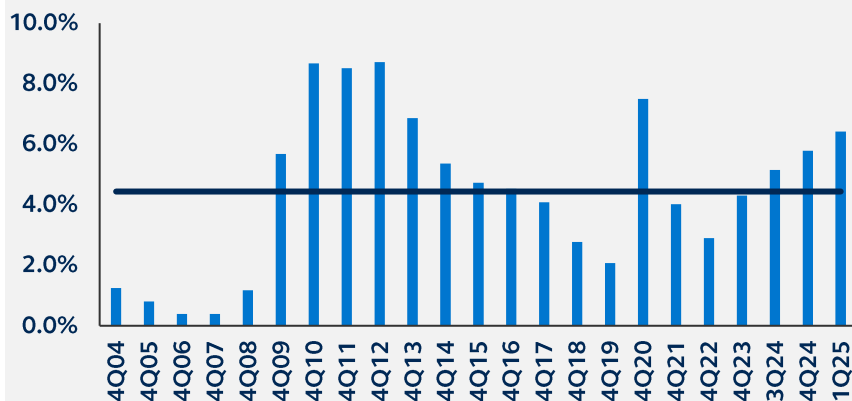
Source: MBA, Principal Real Estate, as of 31 December 2024



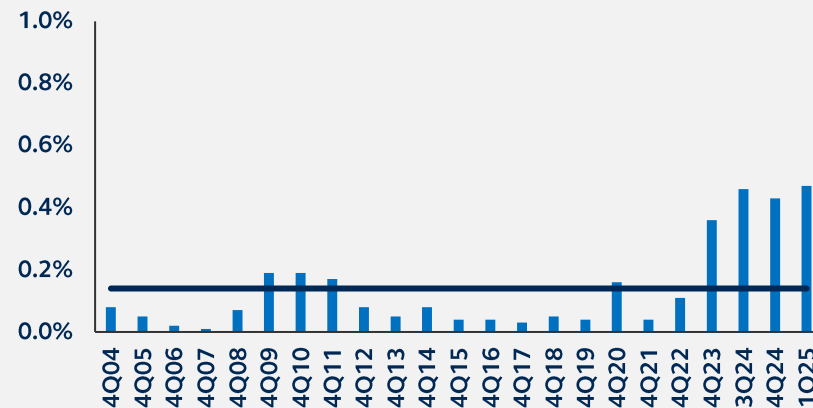
# Delinquency rates are above historical averages

Consistent across all lender types to various degrees

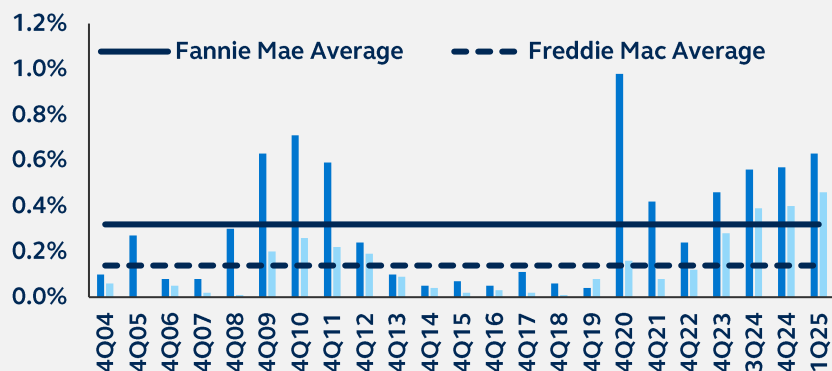
## CMBS (+30 Days and REO)



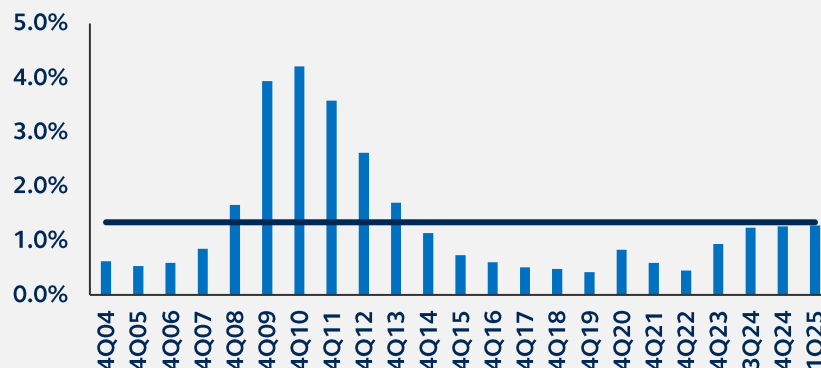
## Life Companies (+60 days)



## Fannie Mae & Freddie Mac (+60 days)



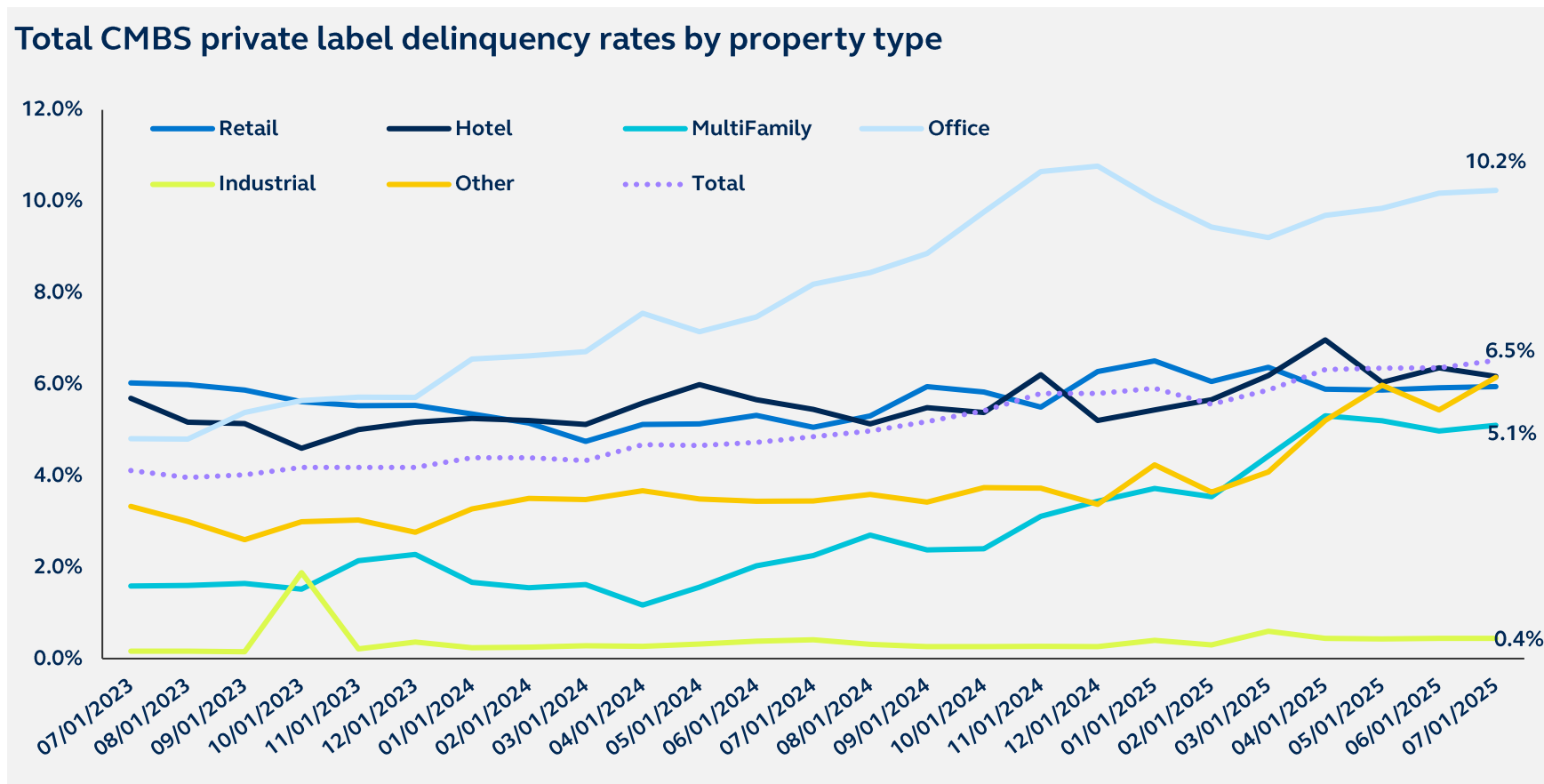
## Banks & Thrifts (+90 Days)



Source: MBA, Principal Real Estate, as of 30 March 2025

# Deeper dive into CMBS delinquencies

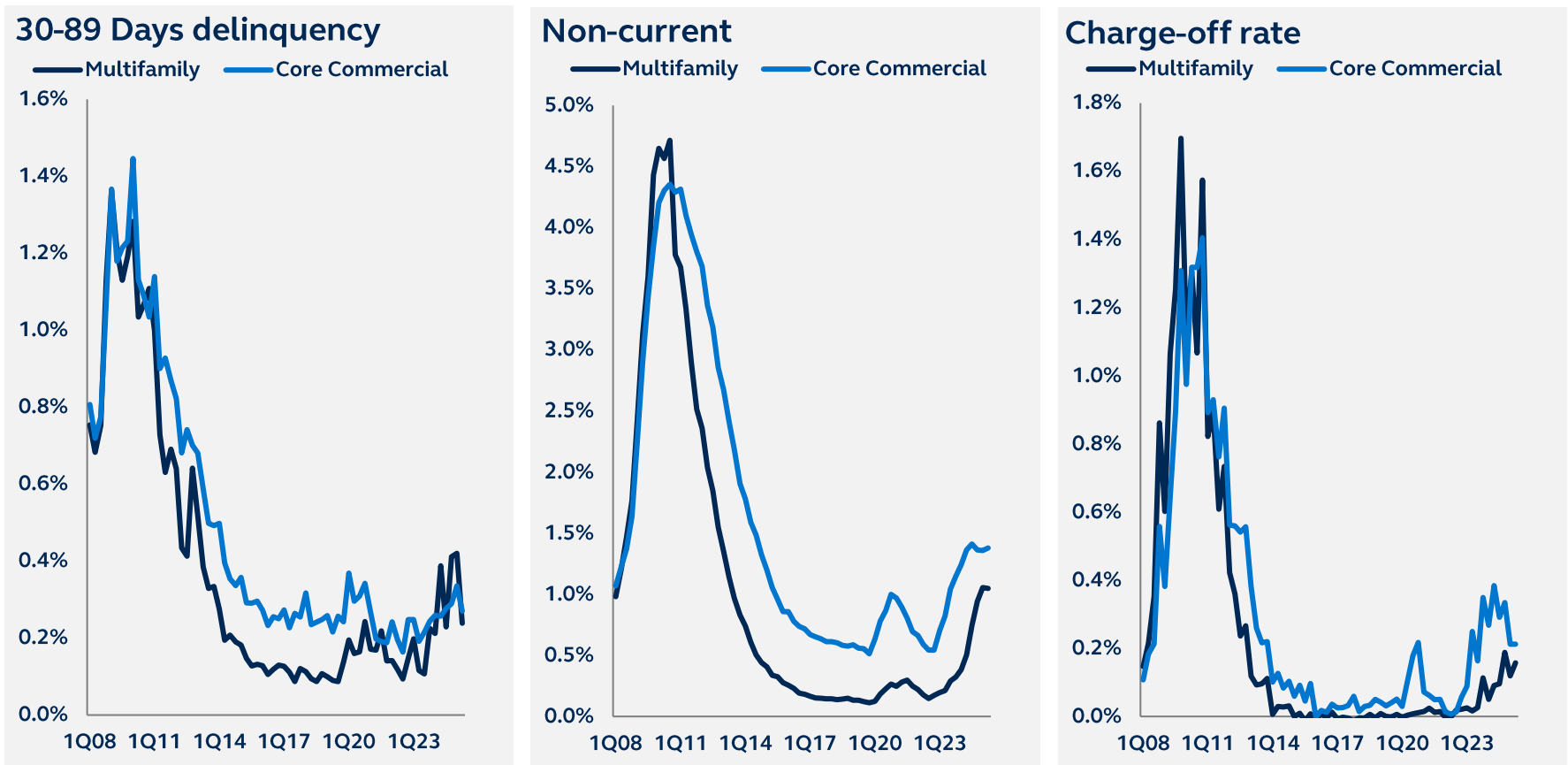
Recall that the CMBS 1.0 delinquency peaked at ~11% with multifamily at +16%



Source: BofA Securities, Principal Real Estate, as of July 2025

# CRE loans on bank balance sheets

Signs of rising distress, but well below peak levels

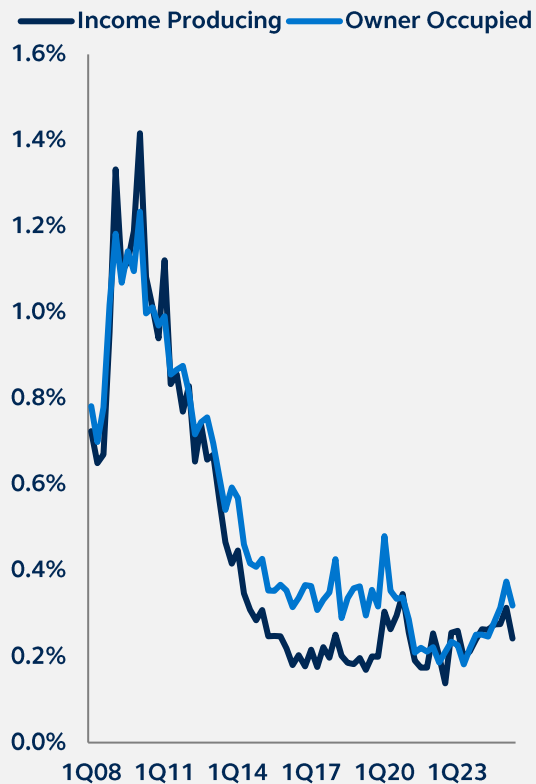


Source: FDIC, Principal Real Estate, as of June 30, 2025

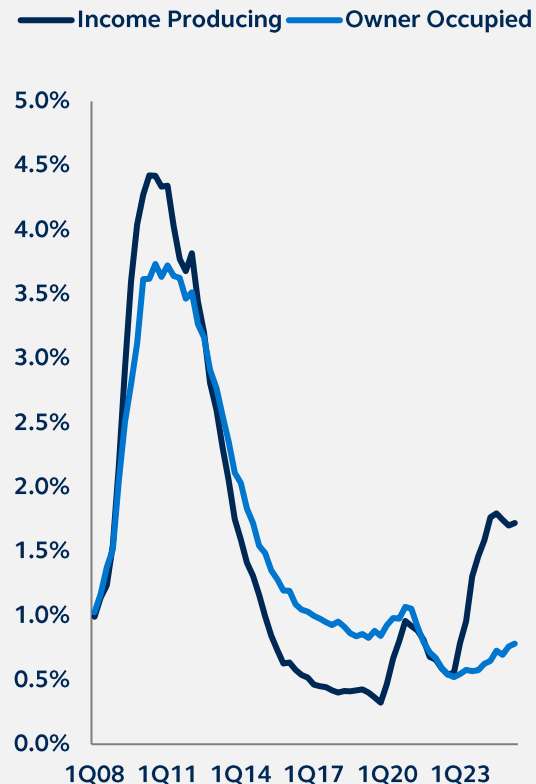
# Owner occupied bank loans outperform income-producing

Delinquencies are similar, but non-performing and charge of rates are low

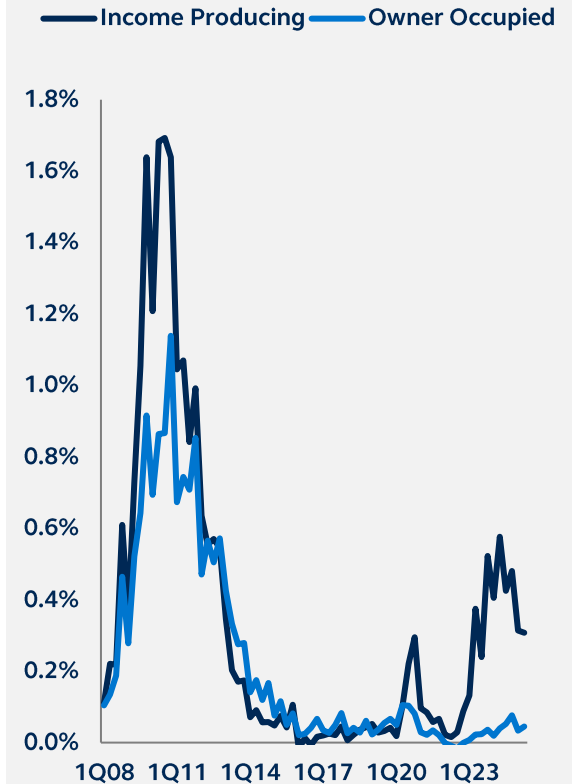
## 30-89 days delinquency



## Non-current rate



## Charge-off rate



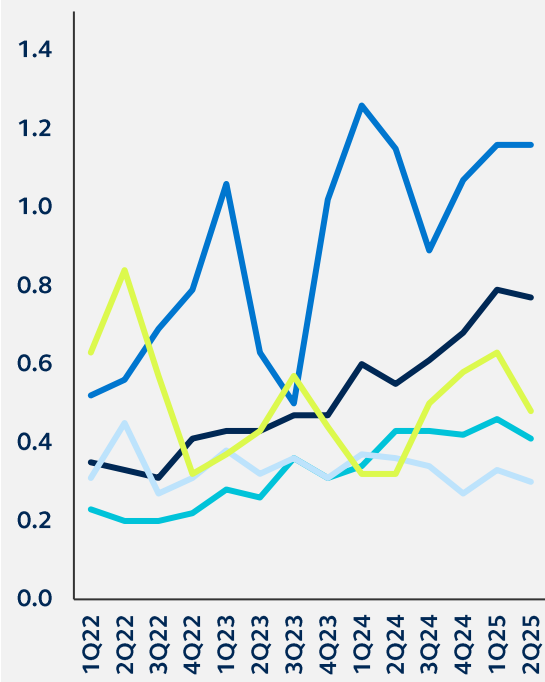
Source: FDIC, Principal Real Estate, as of June 30, 2025

# 30-89 days delinquent loans by bank size

Small banks have a greater % of delinquent core commercial loans

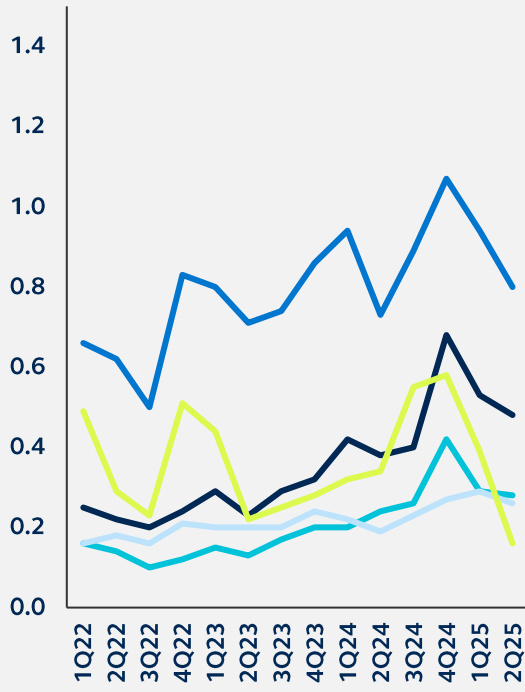
## Construction loans (%)

Legend for Construction loans (%):  
— < \$100mn  
— \$100mn - \$1bn  
— \$1bn - \$10bn  
— \$10bn - \$250bn  
— > \$250bn



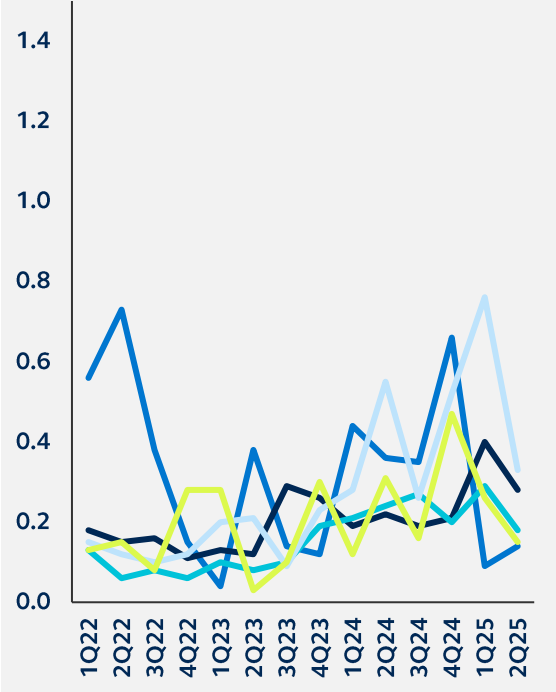
## Core commercial (%)

Legend for Core commercial (%):  
— < \$100mn  
— \$100mn - \$1bn  
— \$1bn - \$10bn  
— \$10bn - \$250bn  
— > \$250bn



## Multifamily (%)

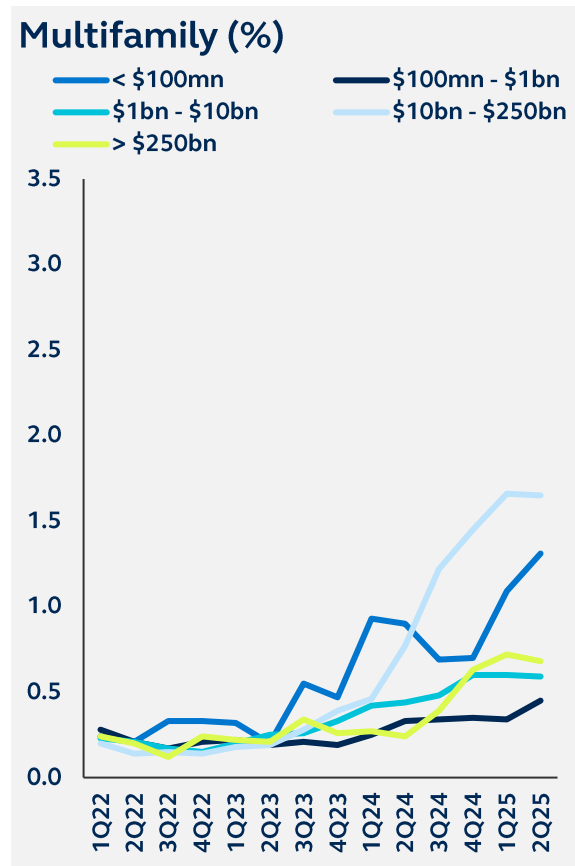
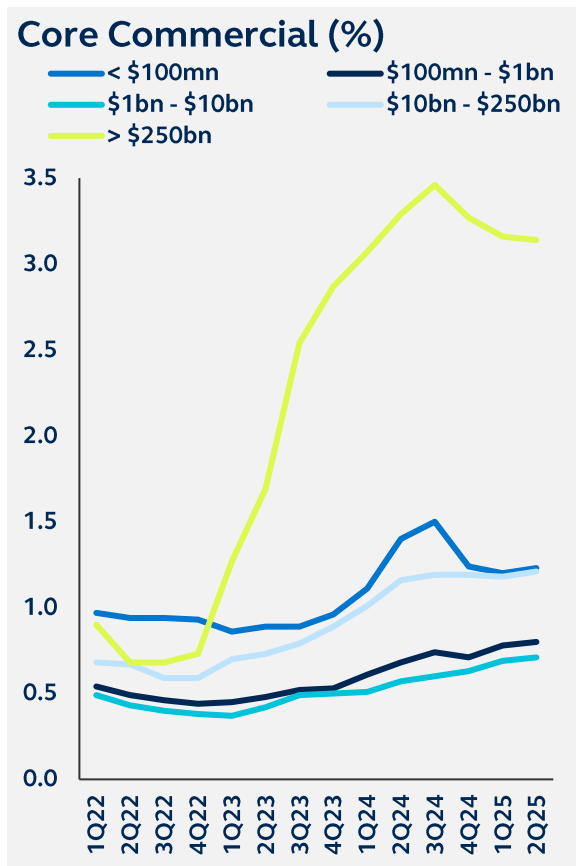
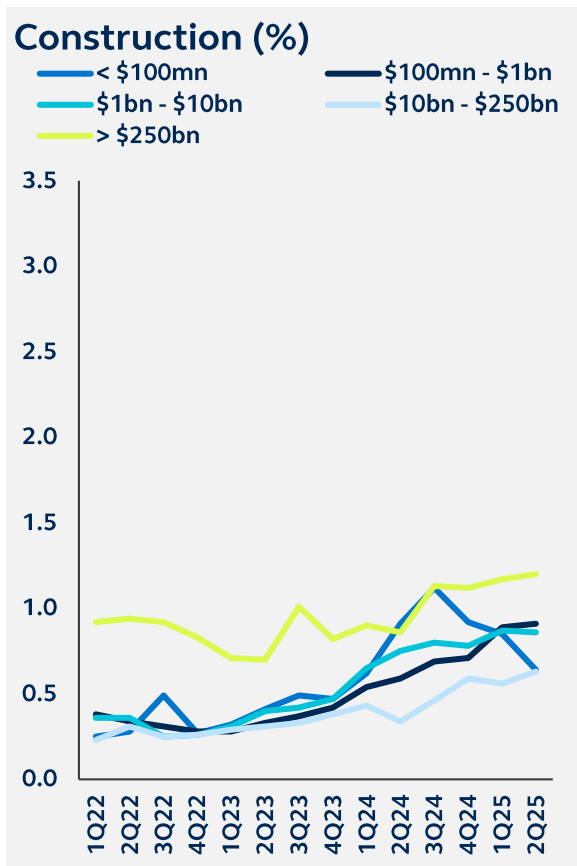
Legend for Multifamily (%):  
— < \$100mn  
— \$100mn - \$1bn  
— \$1bn - \$10bn  
— \$10bn - \$250bn  
— > \$250bn



Source: FDIC, Principal Real Estate, as of June 30, 2025

# Non-current loans by bank size

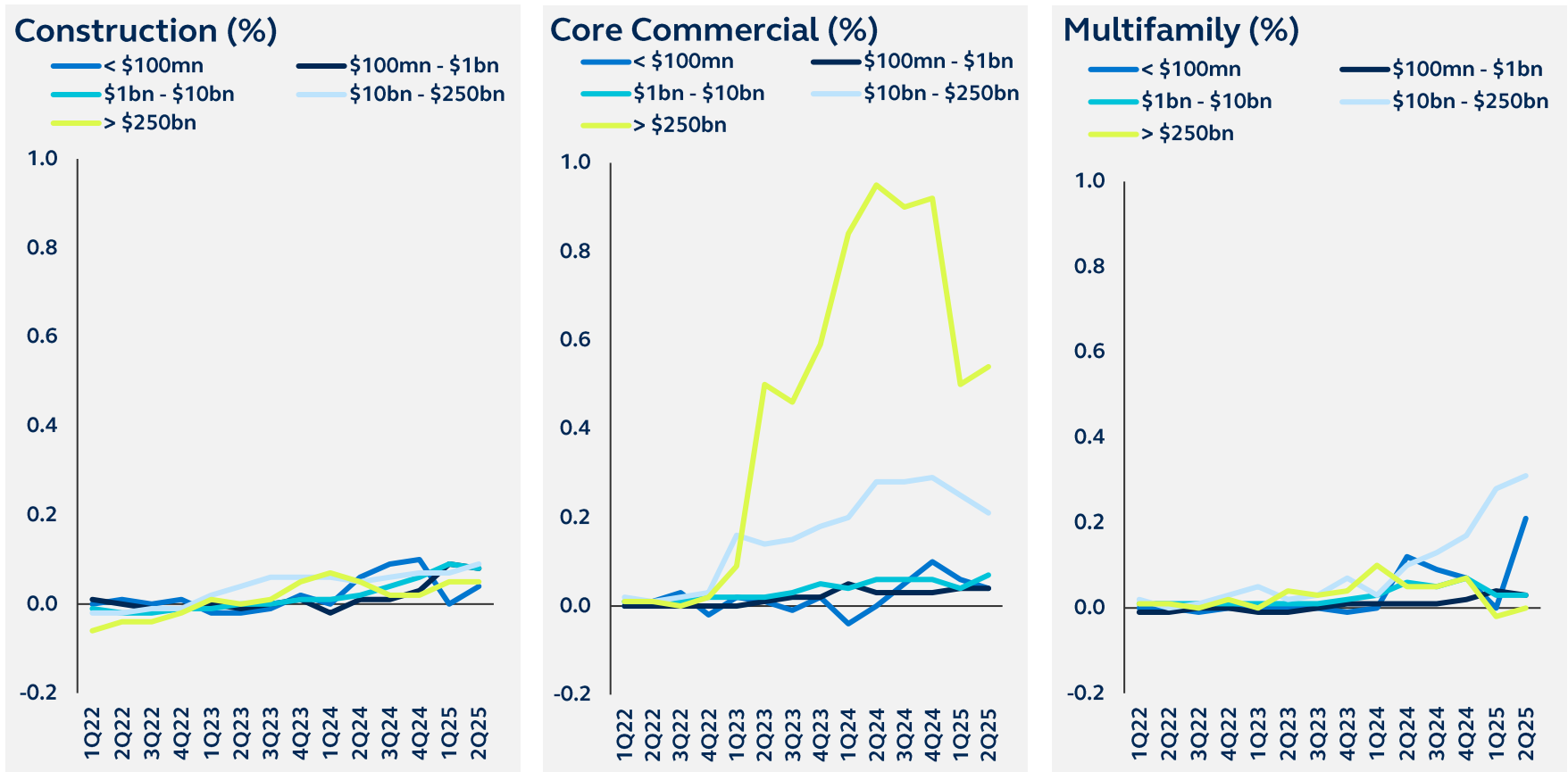
Large banks have a greater % of non-current core commercial loans



Source: FDIC, Principal Real Estate, as of June 30, 2025

# YTD net charge off loans by bank size

Large banks have a greater % of charge-off loans (net, YTD)



Source: FDIC, Principal Real Estate, as of June 30, 2025

# Important information

Real estate investment options, such as real estate investment trusts (REITs) and commercial mortgage-backed securities (CMBS), are subject to risks associated with credit, liquidity, interest rate fluctuation, adverse general and local economic conditions, and decreases in real estate values and occupancy rates. Commercial real estate (CRE) investing carries several inherent risks, including those related to the economy, interest rates, market fluctuations, high upfront costs, and tenant-related issues like defaults or high turnover. Economic downturns can lead to decreased property values and increased vacancy rates, while financing costs, insurance expenses, and potential environmental or structural problems can also pose significant challenges. All these factors and risks can impact rental income and overall investment returns.

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