TPG Angelo Gordon's Capital Markets Perspectives

SECOND QUARTER 2024

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TPG Angelo Gordon's Capital Markets Perspectives (CMP) is a quarterly publication that provides information and our portfolio managers' views on the credit and real estate markets. We hope you find this to be a valuable resource and enjoy our latest look at the markets.

TPG Angelo Gordon is a diversified credit and real estate investing platform within TPG, a leading global alternative asset management firm. TPG Angelo Gordon manages approximately $78 billion* across a broad range of credit and real estate strategies, and we have been investing on behalf of pension funds, corporations, endowments, foundations, sovereign wealth funds, and individuals for 35 years.

Over our entire history, TPG Angelo Gordon's investment approach has consistently relied on disciplined portfolio construction backed by rigorous research and a strong focus on capital preservation.

We have grown by pursuing strategies that complement and build on our core capabilities. Combining deep industry sector and market expertise with a collaborative, knowledge-sharing culture, we creatively seek out investment opportunities that allow us to exploit inefficiencies in global credit and real estate markets.

** TPG Angelo Gordon's currently stated AUM of approximately $78 billion as of December 31, 2023 reflects fund-level asset-related leverage. Prior to May 15, 2023, TPG Angelo Gordon calculated its AUM as net assets under management excluding leverage, which resulted in TPG Angelo Gordon AUM of approximately $53 billion last reported as of December 31, 2022. The difference reflects a change in TPG Angelo Gordon's AUM calculation methodology and not any material change to TPG Angelo Gordon's investment advisory business. For a description of the factors TPG Angelo Gordon considers when calculating AUM, please see the disclosure linked here.*

CMP Overview

Credit markets logged another strong quarter as resilient earnings, strong technical supply dynamics, and improving capital markets activity continued to support record-tight spreads in many markets. Throughout the first quarter, market expectations around Fed interest rate cuts changed significantly. The year began with predictions of a soft landing and a handful of interest rate cuts, with persistently strong economic readings, employment momentum, and inflation prints through March. By the end of the first quarter, however, the market was only pricing in a 67% probability of a single rate cut by the Fed's June meeting, and several forecasters were predicting no cuts at all in 2024.

In corporate credit, the U.S. and European high yield and leveraged loan markets posted positive quarterly returns, with spreads tightening and lower-quality credits outperforming their higher-rated counterparts. However, the market seems to be trading on yield rather than spread, as the rise in Treasury yields was partially offset by spread compression, resulting in modestly higher absolute yields for the quarter. On the demand side of the market, fund flows were positive for both high yield and leveraged loans, with strong CLO formation driving loan prices higher and continuing the refinancing wave that started at the end of the fourth quarter. On the fundamental side, there was a continued increase in the contribution of distressed exchanges in both the high yield and leveraged loan markets in the U.S., but overall corporate fundamentals remained sound.

Within structured credit, spreads tightened across most RMBS and consumer ABS sectors to start the year, with the more subordinated tranches outperforming. After a lighter year of issuance in 2023, primary issuance was remarkably strong in both RMBS and ABS in the first quarter. Consumer performance was supported by the onset of the tax refund season, benefitting sectors such as unsecured consumer loans and auto. While strong new issue demand drove CMBS spreads tighter throughout the quarter, credit trends continued to weaken, driven primarily by an uptick in office loans being transferred to special servicing. CMBS remains cheap relative to alternative structured products, and the large money managers that have been absent in recent quarters seem to be reemerging in the market.

Total U.S. sponsored middle market loan volume was higher in the first quarter. All-in yields for first-lien term loans remained attractive, but we observed dispersion by sector and borrower size. The lower middle market default rate ended 2023 below 1%, while the rates in the core and upper middle markets increased.

Turning to commercial real estate, persistently elevated interest rates coupled with uncertainty about future rate decisions from global central banks continued to cloud the marketplace. Despite stubbornly high inflation, the global economy has demonstrated resilience, adding further complexity to the task facing central banks. This interest rate environment has driven a substantial slowdown in commercial real estate investment activity, as both buyers and sellers grapple with price discovery amid limited comparable transactions and financing availability. While higher rates have led to notable valuation declines, uncertainty remains regarding how much further values will deteriorate before stabilizing. Overall, fundamentals across many real estate sectors remained on relatively sure footing as future supply has been constrained by higher financing costs, which should continue to support sector fundamentals. Despite lingering uncertainty, we believe that the current market dynamics will create openings to identify high-quality assets at reset valuations, presenting a significant investment opportunity.

In the U.S., with the consensus view of a soft landing now somewhat clouded, market participants have remained on the sidelines. Investment volume was down close to 50% year-over-year as of the end of February, reflecting uncertainty about pricing, elevated debt costs, and limited availability of financing. The challenges posed by the upcoming wall of maturities are becoming apparent, as delinquencies in commercial real estate debt have increased materially. Meanwhile, fundamentals across most real estate sectors – with the exception of office – have remained strong, though there have been indications of oversupply in certain markets, particularly in the multifamily and industrial sectors.

In Europe, the ECB surprised the market by maintaining its record-high base rate in April, highlighting the ongoing challenge of managing sustained inflationary pressures. Unlike in the U.S., the European economy has been sluggish, with no growth in eurozone GDP reported in 2023. Against this backdrop, the commercial real estate market has been under considerable pressure, with investment volume down materially from recent peaks and valuations declining. We continue to expect that the material amount of debt maturing starting in late 2024 will result in a significant amount of stressed and distressed sellers entering the market.

Across Asia, the commercial real estate market has been less impacted by global macroeconomic pressures. Inflation has generally been well managed throughout the region, and GDP growth has remained relatively stable. While certain markets – such as Korea and Hong Kong – have grappled with increased interest rates, overall, real estate fundamentals have remained favorable across the region.

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Co-Managing Partner
of TPG Angelo Gordon
Head of Credit

Adam Schwartz
Co-Managing Partner
of TPG Angelo Gordon
Head of Real Estate

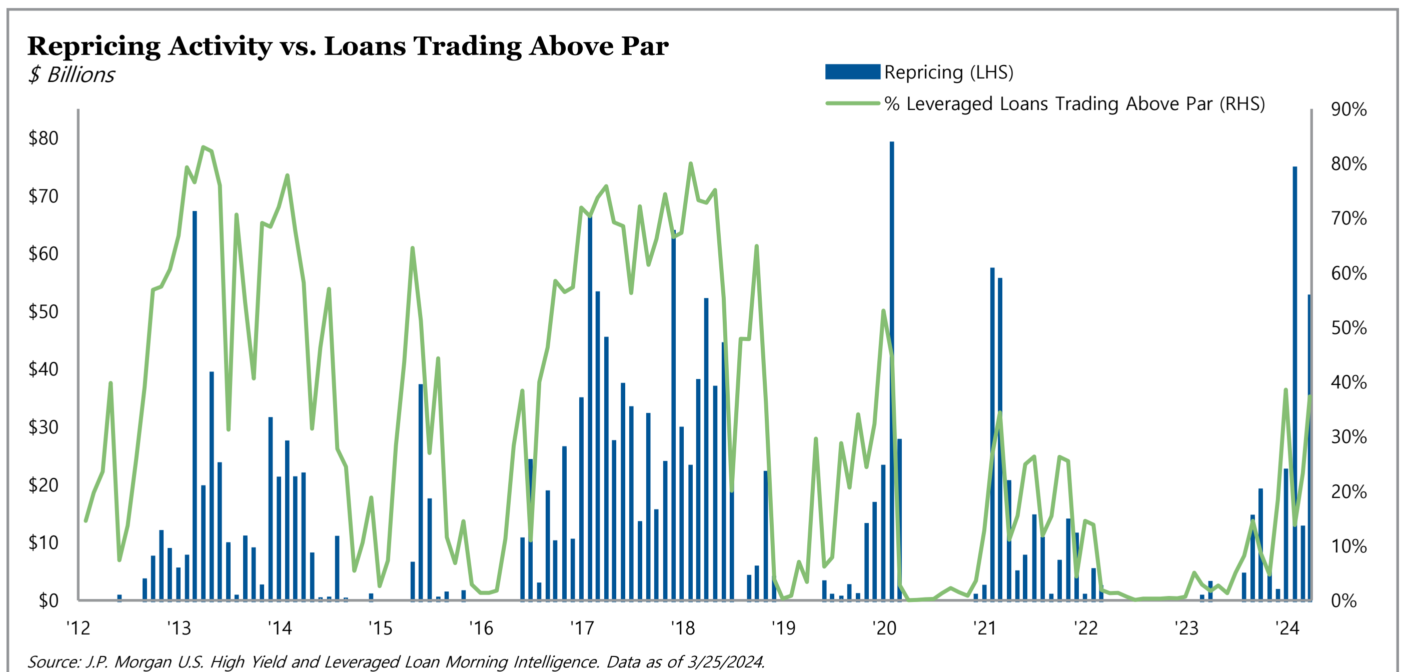
Leveraged Loans

Leveraged loans continued their impressive performance to start the year. In the first quarter, the J.P. Morgan U.S. Leveraged Loan Index posted a 2.6% return, ending March with an 8.8% yield to maturity and a spread of 476 basis points. Leveraged loans outperformed both investment grade and high yield bonds, which returned -0.3% and +1.6%, respectively. Lower quality credits outperformed, with CCC-rated leveraged loans up 5.14% while BBs were up 2.01%. In Europe, the J.P. Morgan European Leveraged Loan Index posted a 2.5% quarterly return, ending the first quarter with a spread of 535 basis points and yield of 8.2%.

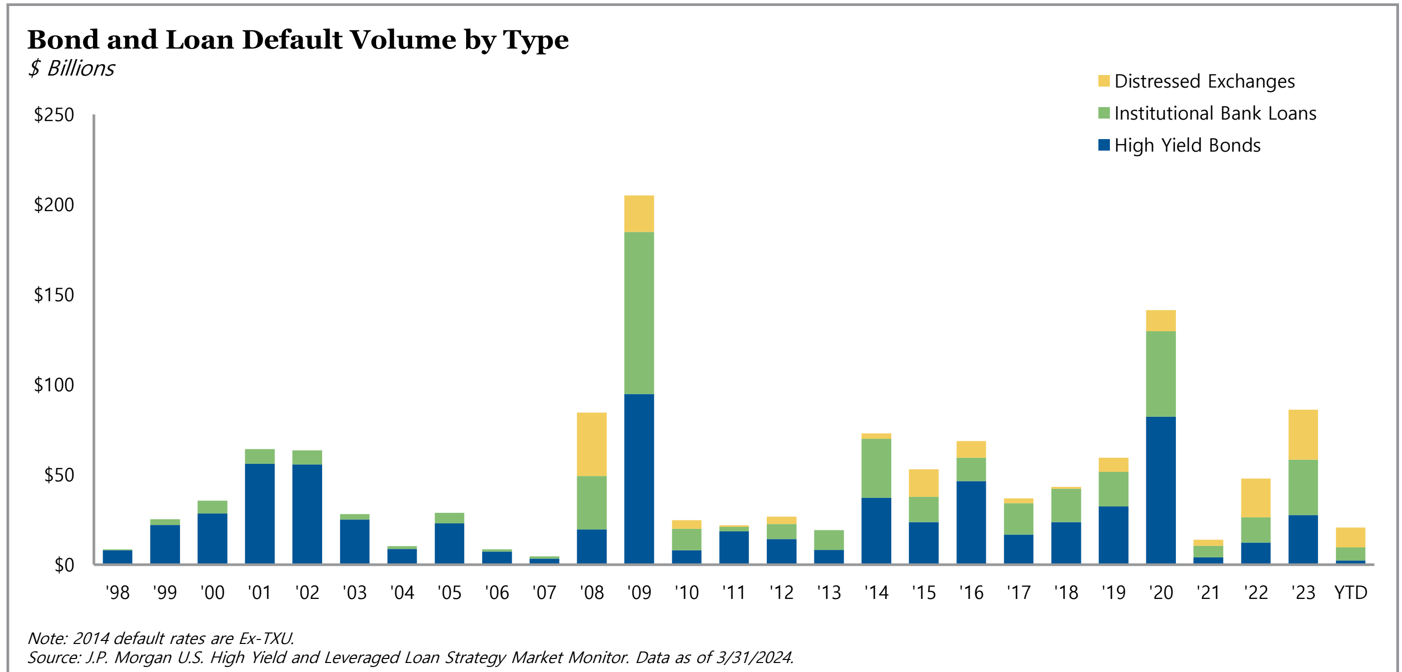
A strong technical supply-demand dynamic has been contributing to the positive performance in this space. On the supply side, first-quarter U.S. institutional loan issuance totaled $317.7 billion, marking the second-most-active quarter on record. However, proceeds were predominantly used for repricing and refinancing, which comprised 88% of total quarterly issuance. As a result, the institutional leveraged loan maturity wall saw some near-term relief, with recent refinancings taking out nearly $35 billion of loans set to mature through 2025.

On the demand front, the string of record months of CLO issuance continued; total quarterly issuance amounted to $84 billion, which represents over 60% of total CLO issuance in 2023. Additionally, leveraged loan fund flows rebounded from 2023's $17 billion outflow, with a $2.8 billion inflow recorded in the first quarter. While strong technical signals have been observed, fundamentals have been weakening off a strong base, and distressed transactions have been a larger component of the default landscape. The trailing twelve-month default rate for U.S. leveraged loans, including distressed exchanges, ended the first quarter at 3.52% – slightly above the 25-year average of 3.0%.

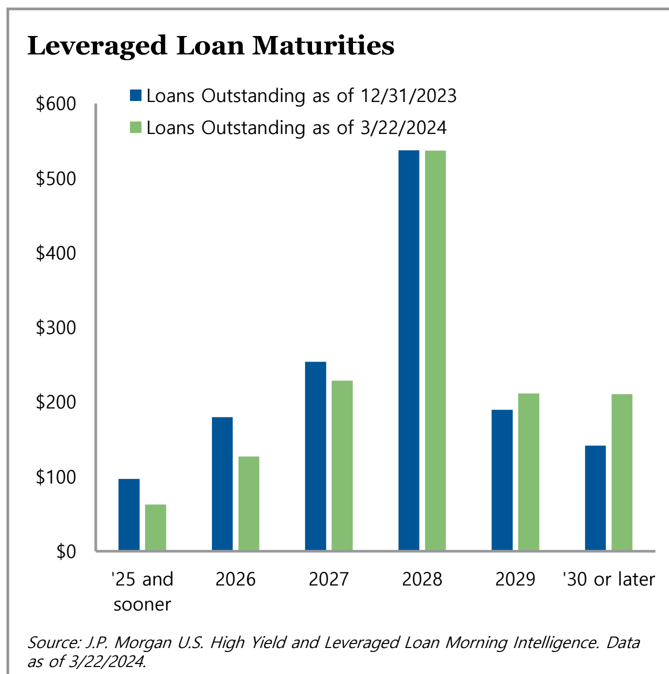
With the broadly syndicated loan (BSL) market largely closed to leveraged credits throughout 2023, BSL issuers had increasingly been tapping the private credit market to refinance their existing debt last year. Interestingly, the first quarter appeared to mark a notable shift in that trend, with $11.8 billion of private market loans being refinanced in the BSL market, whereas only $2.7 billion of broadly syndicated loans were refinanced in the private market, according to PitchBook LCD. A driver of this shift was the potential net cash interest savings versus original costs for loans refinanced into the BSL market, which approached an average of 160 basis points at the end of the first quarter.



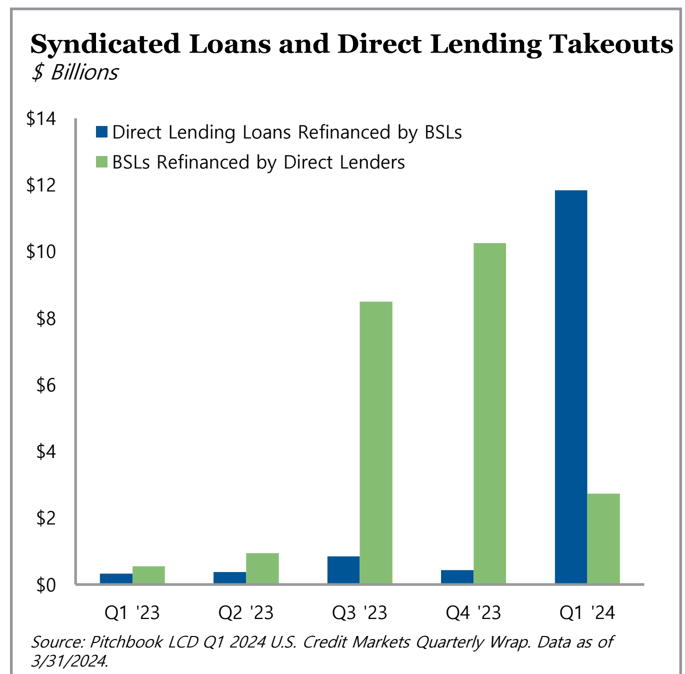
The percentage of loans trading above par remained elevated at the end of the first quarter, driven by technical tailwinds from positive fund flows and robust CLO formation.



In the U.S. leveraged loan market, the trend of increased distressed exchanges continued in the first quarter, with more than half of the default volume coming from distressed exchanges.



Significant repricing activity in the first quarter enabled issuers to push out maturities, partially relieving the near-term wall of maturities.



After a year of existing BSL issuers increasingly turning to private credit for refinancings, the first quarter marked a notable reversal of 2023's trend.

Maureen D'Alleva
Head of TPG AG CLOs

For more information on TPG AG CLOs, click here.

High Yield Credit

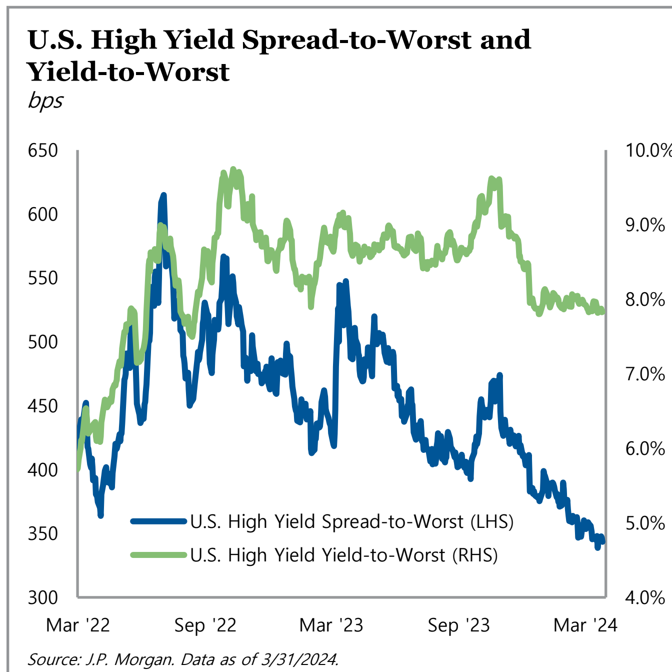
U.S. high yield bonds gained 1.62% and European high yield markets rose 1.35% in the first quarter, with stronger-than-expected corporate earnings and more active new issuance in the capital markets driving positive returns.

In the United States, high yield bond spreads tightened 34 basis points over the first three months of the year, ending the quarter at 343 basis points after touching a five-year low of 339 basis points in March. Yields continued to hover around 8%, ending the quarter at 7.8%. Lower-rated bonds outperformed higher-quality bonds, as CCCs gained 4.0% while BBs generated a 1.2% return in the first quarter. In Europe, high yield spreads compressed 31 basis points to close the first quarter at 430 basis points. Lower-quality CCCs significantly lagged BBs in Europe during the quarter, losing 1.9% versus gaining 1.5%.

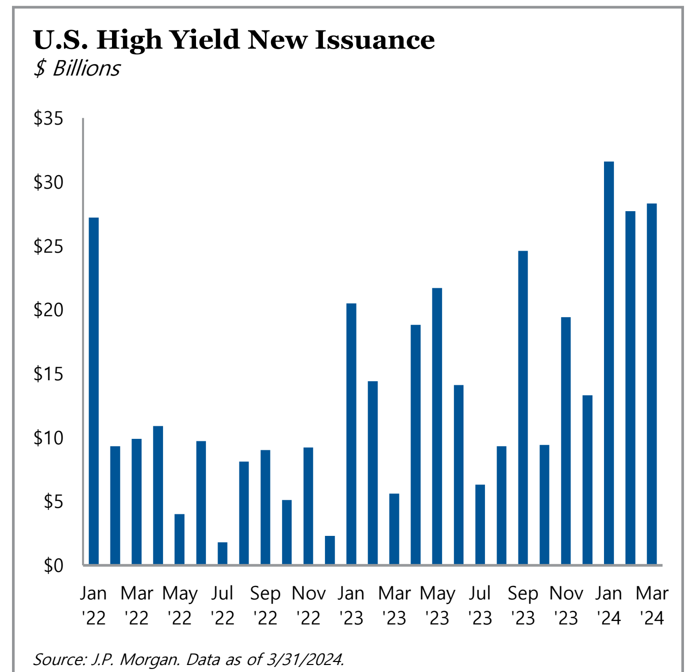
During the first quarter, 14 U.S. companies defaulted or completed a distressed exchange on a combined $11 billion of debt. Despite this volume, the 12-month trailing default rate declined from 2.8% to 2.6%. In the same three-month period, the European high yield market experienced two defaults, which drove the default rate modestly higher, from 2.4% to 2.6%.

After U.S. high yield primary activity totaled just $176 billion in 2023, new issuance rebounded with approximately $88 billion of volume during the first three months of 2024, resulting in the most active quarter since the third quarter of 2021. In Europe, high yield new issuance totaled €26.5 billion in the first quarter, with €13.9 billion coming in March – the highest monthly volume since October 2021.

After $7.0 billion of outflows in 2023, U.S. high yield mutual funds experienced inflows of $2.6 billion during the first quarter. In Europe, high yield funds experienced inflows of €4.7 billion, marking the best quarter for new subscriptions since the second quarter of 2020.



While yields remained steady, spreads continued to tighten, ending the first quarter near a five-year low.



Primary issuance in each of the first three months of 2024 exceeded issuance in every month of 2022 and 2023.

Ryan Mollett
Global Head of TPG AG Credit Solutions

For more information on TPG AG Credit Solutions, click here.

Structured Credit: RMBS

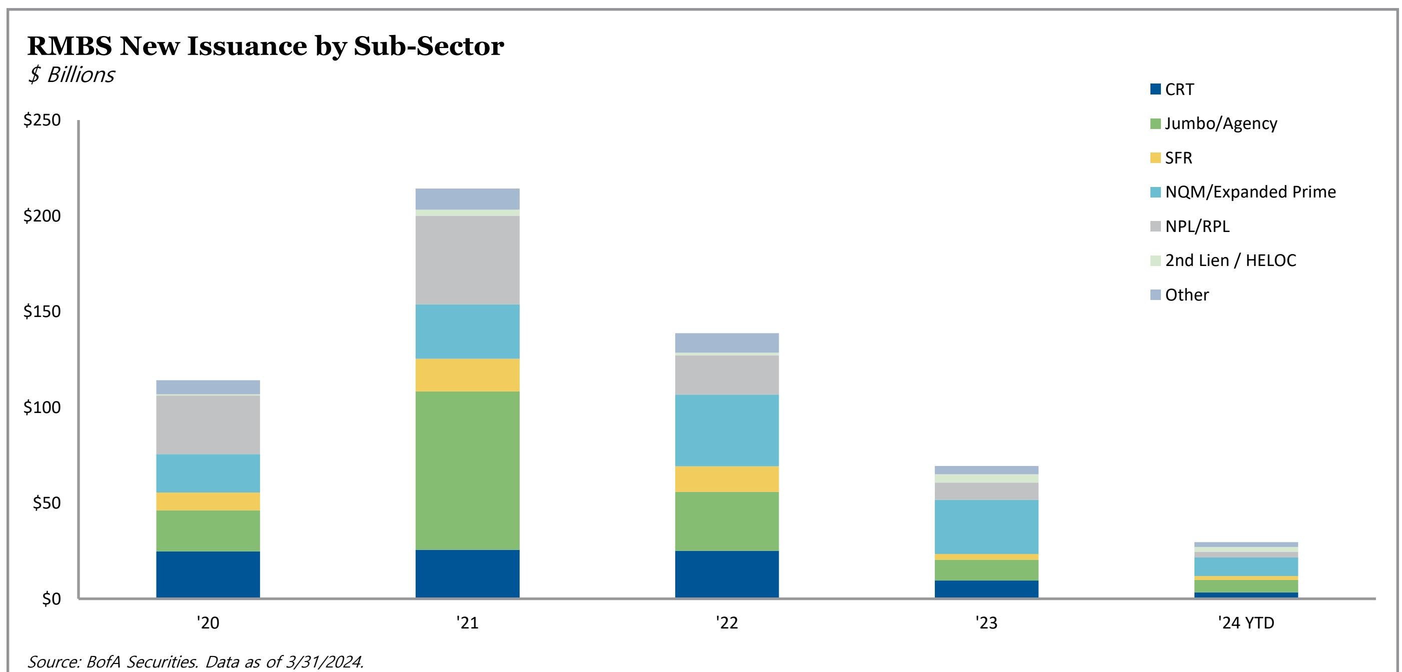
RMBS spreads sharply rallied during the first quarter amid strong investor appetite for U.S. housing and mortgage credit. Credit risk transfer (CRT) tranches were tighter by 50-200 basis points, and the sector's credit curve flattened significantly. Senior non-qualified mortgage (NQM) spreads were around 40 basis points tighter during the quarter, and BBB- and BB-rated NQM were 70 and 120 basis points tighter, respectively. First-quarter total returns were between 2-4% for mezzanine CRT tranches and 4-6% for subordinates, and legacy RMBS returned around 1-2%.

Primary RMBS issuance was off to a strong start during the first quarter, totaling nearly $30 billion – up 56% year-over-year and 73% quarter-over-quarter. Securitizations backed by NQM and prime jumbo collateral led this trend, collectively comprising over half of the quarter's issuance. Second-lien collateral, including closed-end loans and home equity lines of credit (HELOCs), totaled $2.6 billion – or 9% of new issuance – and CRT comprised around 11% of the activity. Primary issuance in 2023 totaled just $69 billion, amid a lull in mortgage origination activity after almost $140 billion of new bonds were issued in 2022.

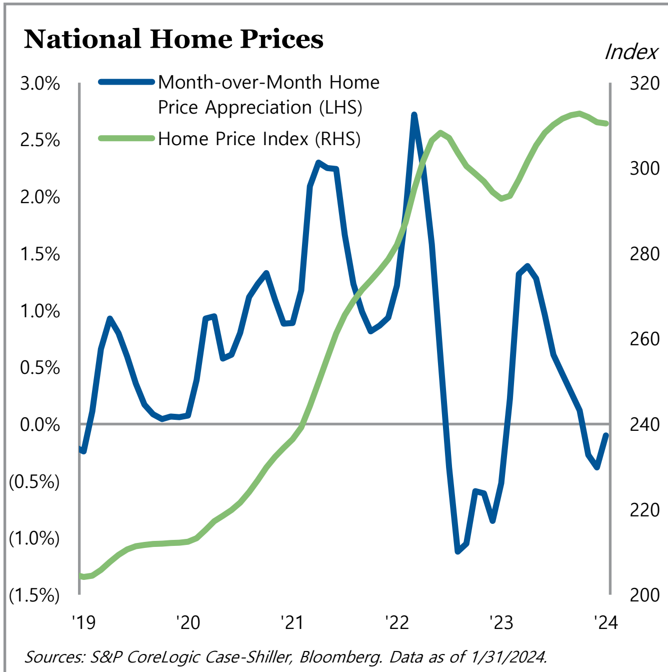
The S&P CoreLogic Case-Shiller U.S. National Home Price Index was up 6% year-over-year in January 2024. However, home prices were little changed over the preceding several months, with the Index just below its October 2023 peak and in line with the prior peak in June 2022. Recall that home prices had fallen by approximately 5% from June 2022 to January 2023, before recovering throughout last year. Home prices continue to vary by geography. Since June 2022, home prices in west coast MSAs as well as Phoenix, Dallas, and Denver have declined 6-12%, while prices in MSAs like Chicago and Detroit are up 3-5%; home prices in Miami and NYC are 6% higher as well. A survey of research shows varied home price expectations in 2024, ranging from -3% to +5.5%.

Prevailing mortgage rates inched higher to 6.8%, up from 6.6% at year-end 2023, and continued to rise in the first weeks of the second quarter. Recall that mortgage rates reached 7.8% during the fourth quarter of last year, the highest level since November 2000. The effective mortgage rate outstanding was 3.8% as of December 2023, creeping up from 3.3% in March 2022, reflecting the inclusion of higher-rate originations in the second half of 2022 and 2023. The well-publicized "lock-in effect" remains in full force, with most estimates showing a very small share of outstanding mortgages in-the-money to refinance.

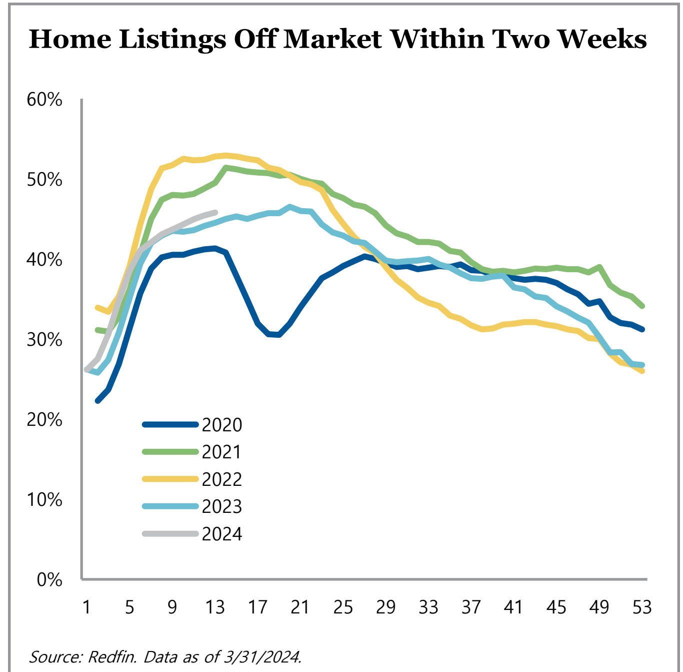
Total existing home listings were 1.07 million in February, remaining in line with most of 2023 but down significantly from pre-pandemic years. On a national level, new listings were a little higher year-over-year in January and February but still weak overall.



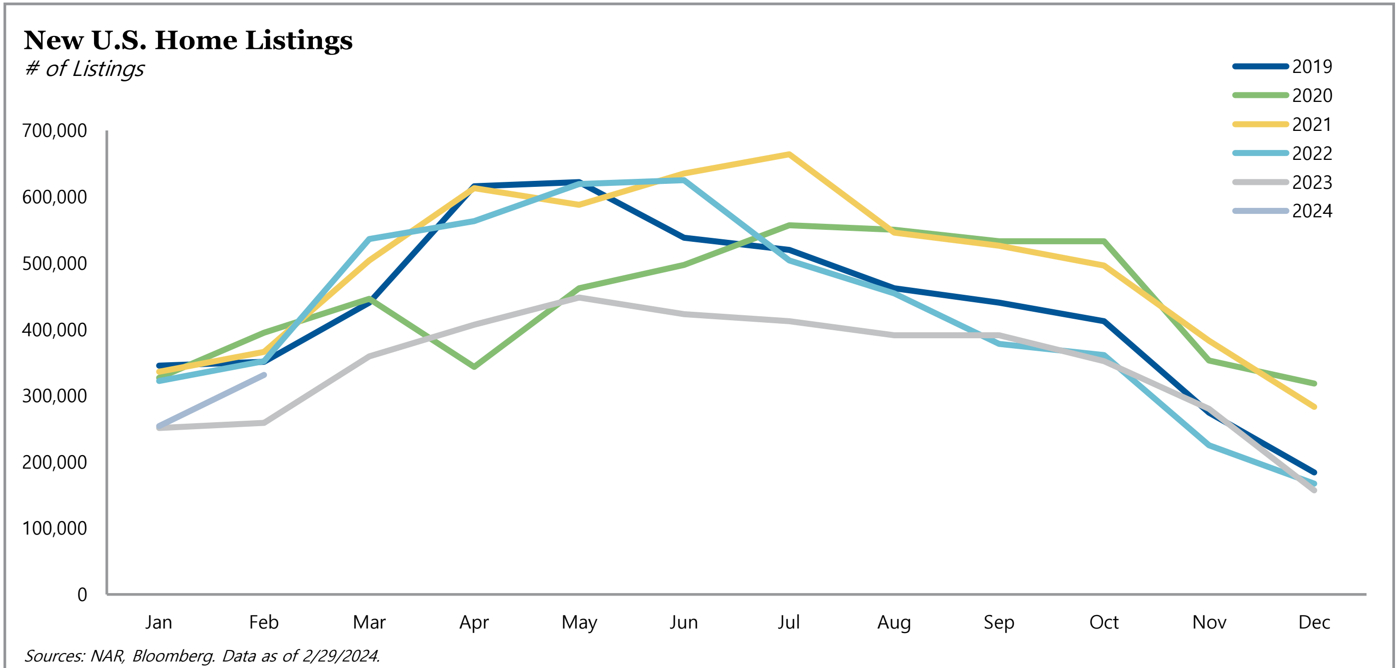
RMBS issuance was up 56% year-over-year in the first quarter.



Home prices have flattened since recovering in 2023.



Housing demand is evident given the percentage of listings off market within two weeks remains high.



Few new listings came to market in the first two months of 2024.

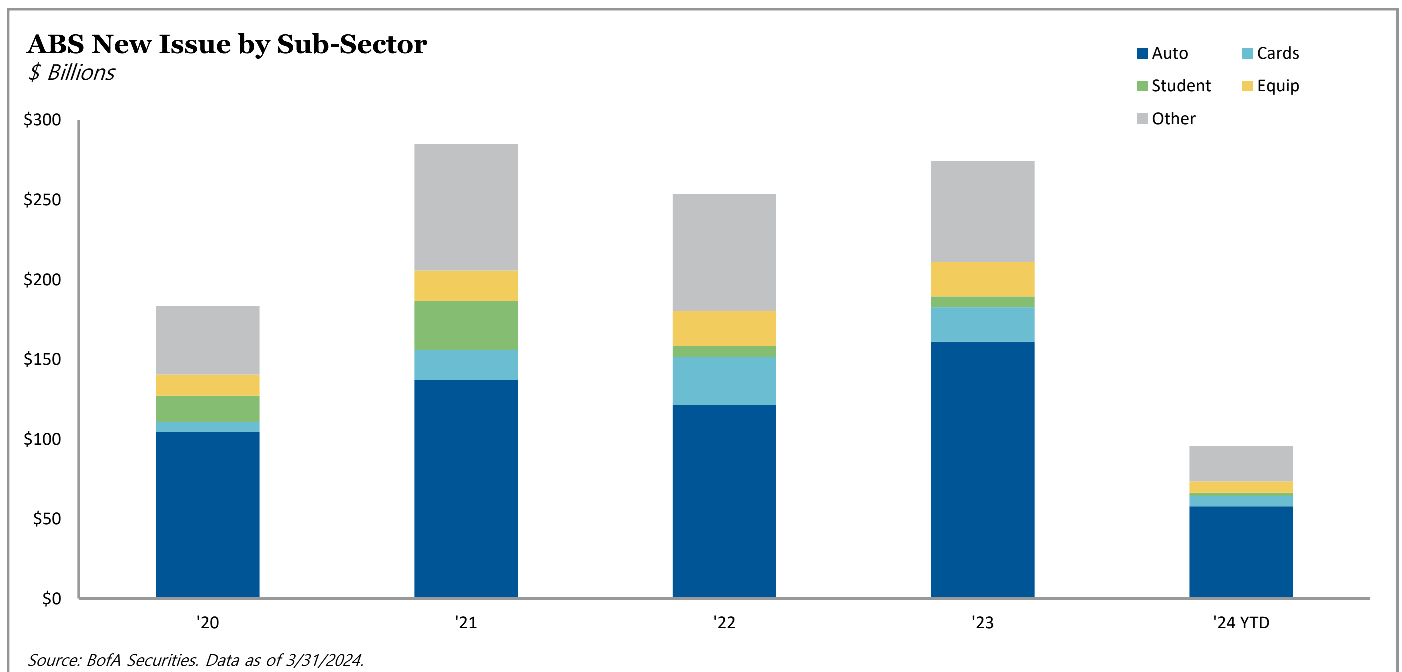
Structured Credit: ABS

ABS spreads were off to a strong start and, like RMBS, rallied during the first quarter. Benchmark ABS sectors such as student loans and credit cards were generally 5-15 basis points tighter, though subordinate student loans were as much as 30 basis points tighter. In a reversal of last quarter, subprime auto ABS tightened by 55 basis points for single-A profiles, 70 basis points for BBB, and 145 basis points for BB, resulting in a much flatter credit curve for the quarter. The credit curve for unsecured consumer loans similarly flattened, with single-A tranches 75 basis points tighter and BB-rated tranches over 200 basis points tighter.

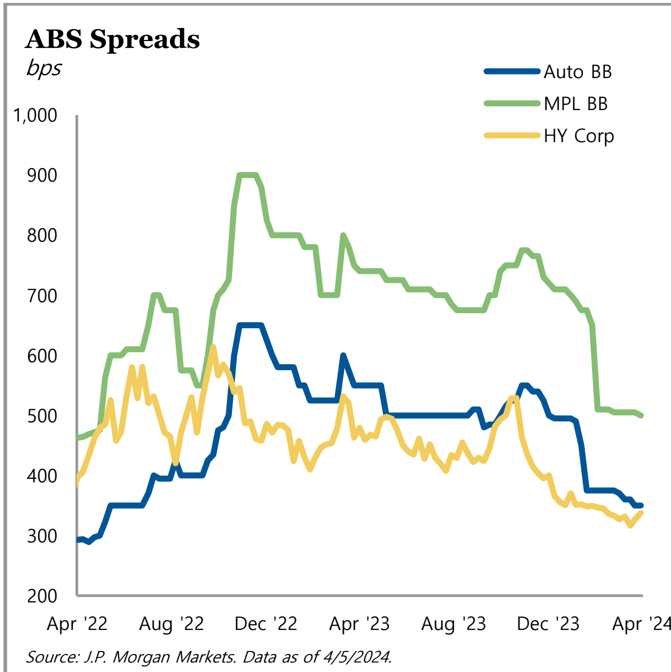
Primary issuance activity totaled $96 billion in the first quarter, up 51% from year-ago levels. While all sectors grew on an annual basis, issuance for autos led the period – rising over $20 billion to $58 billion in the first quarter – and credit cards followed, up nearly $5 billion to $6.4 billion; esoteric ABS, student loans, and equipment were higher by a few billion dollars each. Within the auto sector, prime loans comprised a majority of the issuance at $24.6 billion, followed by non-prime loans at $13 billion and leases at $12 billion.

Consumer performance data felt some relief during the first quarter with the onset of the tax refund season. Unsecured consumer loans improved, and further performance improvement is anticipated over the next several months as additional borrowers receive tax refunds. Auto performance data improved for similar reasons; auto delinquency and default rates fell, and repayments for subprime and deep subprime auto loans rose but remained close to historic lows. Credit card performance continues to be stable with high payment rates and muted charge-off rates that, for now, remain below pre-pandemic levels. Overall student loan performance was benign with reduced early delinquency rates and lower defaults, also benefitting from tax refunds. Recoveries on legacy private credit student loans continued to surpass new defaults.

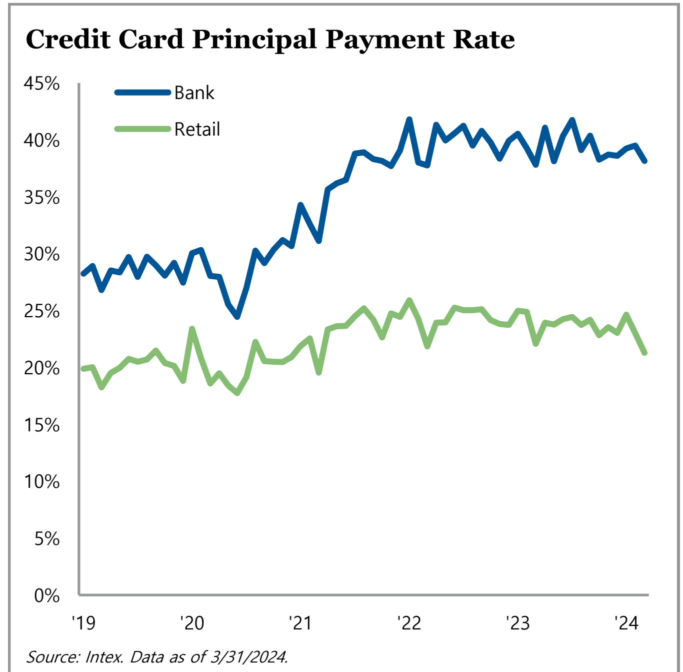
On the regulatory front, the CFPB finalized its rule setting a new $8 safe harbor cap for credit card late payment fees, significantly below the previous $32 average fee. Not surprisingly, the final rule prompted a lawsuit from the U.S. Chamber of Commerce and other industry groups. Federal student loan payments – proxied using remittances by the Department of Education – remain below pre-pandemic levels, as borrowers are still within the 12-month on-ramp we have discussed in previous CMP reports. We believe the payment resumption will have a limited impact on the broader consumer ABS complex, as federal student loans tend to be at the bottom of payment hierarchies given small minimum payments, the availability of forbearance, and the long delay before adverse action is taken.



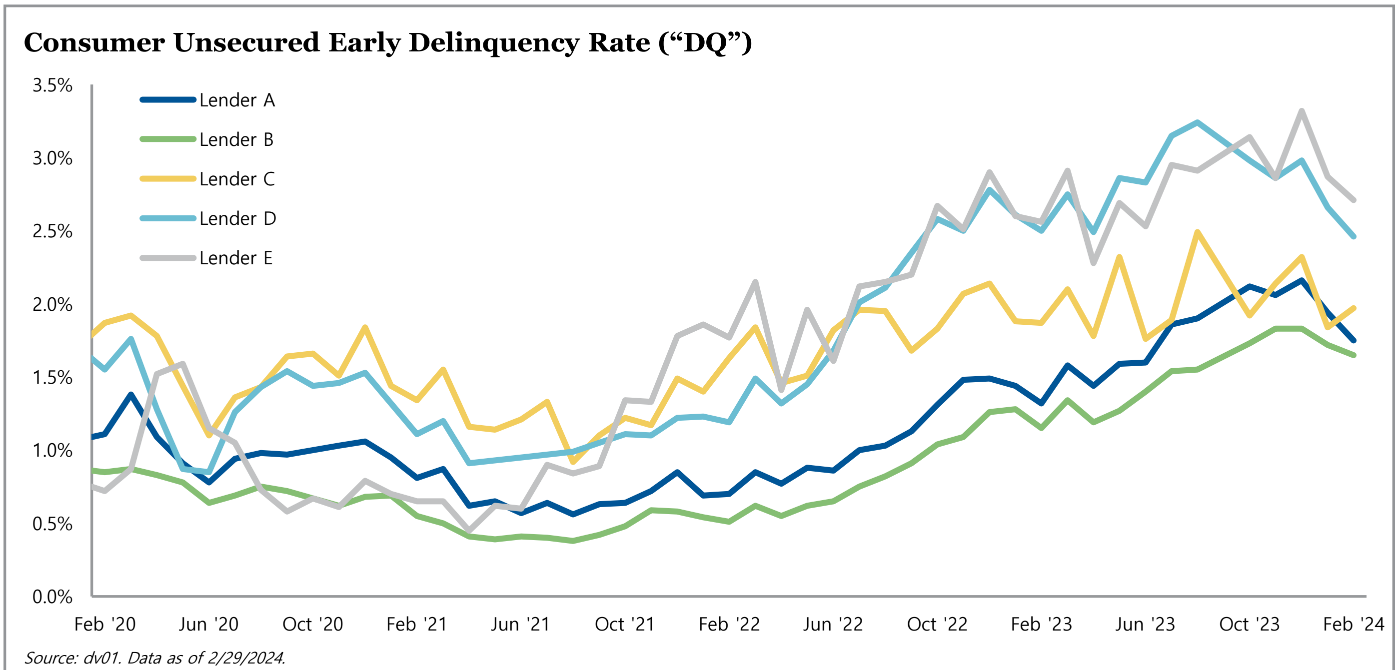
ABS issuance was up 51% year-over-year in the first quarter.



ABS spreads rallied during the first quarter.



Credit card principal payment rates have been generally stable.



Delinquencies for unsecured consumer loans seasonally improved with tax refunds.

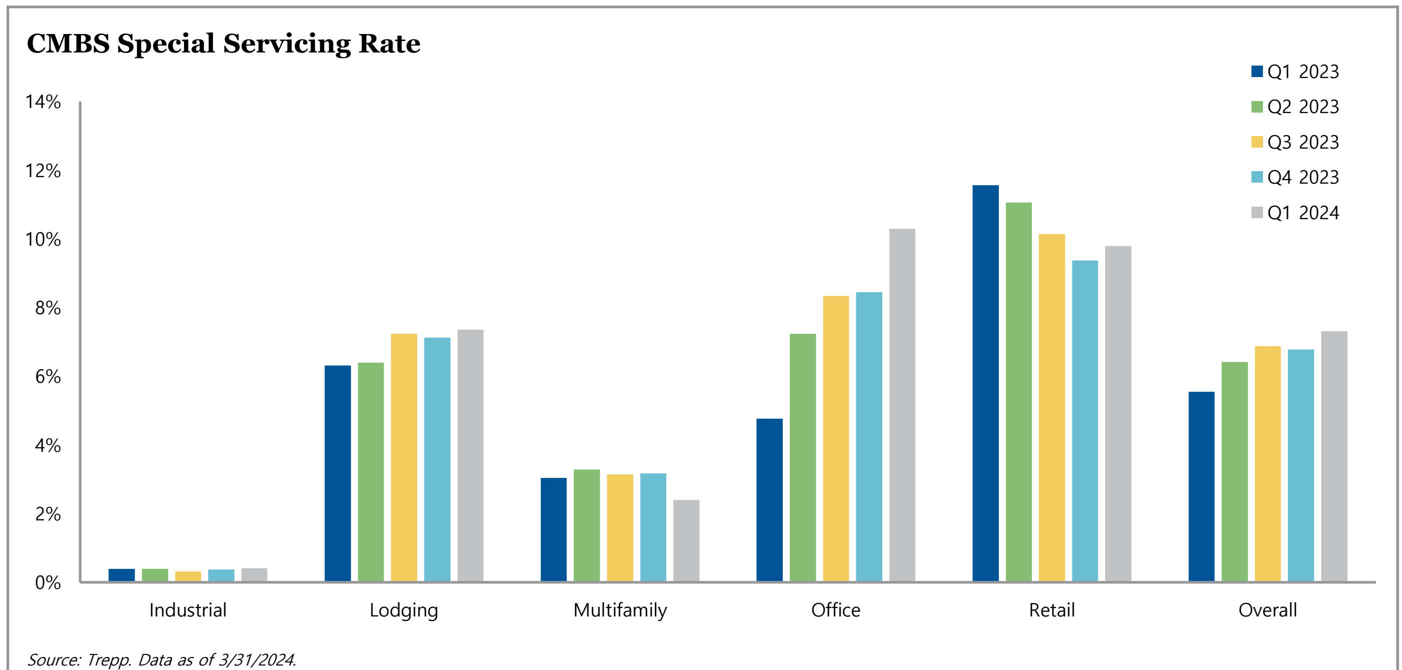
Structured Credit: CMBS

CMBS spreads and interest rates diverged in the first quarter, as benchmark rates moved higher and secondary-market CMBS spreads grinded tighter. AAA CMBS spreads are once again inside of 100 basis points, ending the quarter at 86 basis points – within 20 basis points of their 7-year average of 70 basis points. As AAA-rated tranches tightened, the investment community's confidence that the lending market is reopening increased. As a result, secondary-market BBB- spreads tightened approximately 120 basis points during the quarter. Averages moved, but the dispersion among securities viewed as "safe" relative to those with high concentrations of out-of-favor properties remains significant.

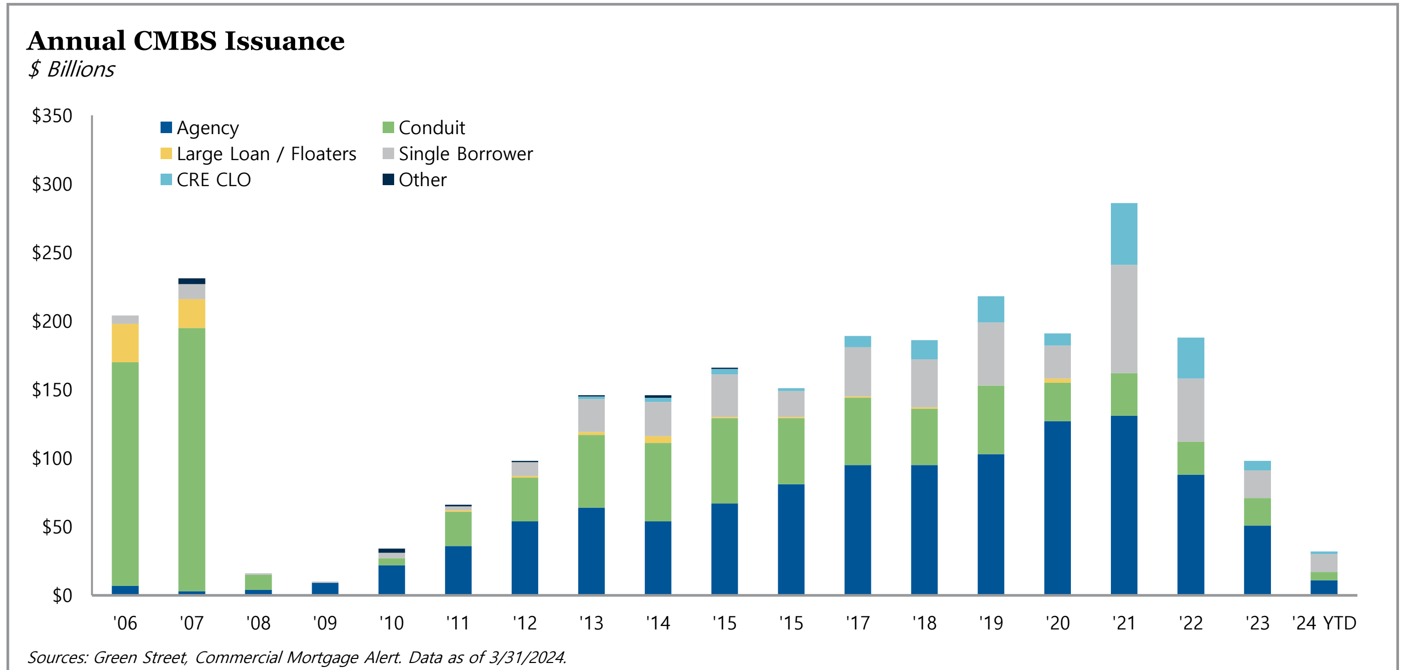
While spreads rallied in the first quarter of 2024, credit trends remained consistent relative to 2023. As of the end of March, the CMBS special servicing rate increased 53 basis points to 7.31%. Not surprisingly, the increase was primarily due to an 18% uptick in office loans being transferred to special servicing, as maturing loans are meeting a financing market unreceptive to the office property type. Meanwhile, property types other than office experienced limited changes in special servicing rates, with loans transferred to special servicing typically being moved due to property-specific issues – not broader sector concerns.

The awakening of the CMBS market in the fourth quarter of 2023 continued into the first quarter of 2024, putting the primary CMBS market in a better place. The year started hot, with four conduit deals pricing in January. Each issuance was well received, with tranches as much as ten-times oversubscribed, leading issuers to tighten spreads as the quarter progressed. A mix of conduit and single-asset/single-borrower (SASB) deals totaling 23 transactions priced during the quarter, and the period ended with a flurry of SASB issuance, as sophisticated borrowers sought to take advantage of the healthy securitization market. The demand for these transactions will likely create a virtuous cycle, leading to increased new issuance as the year progresses.

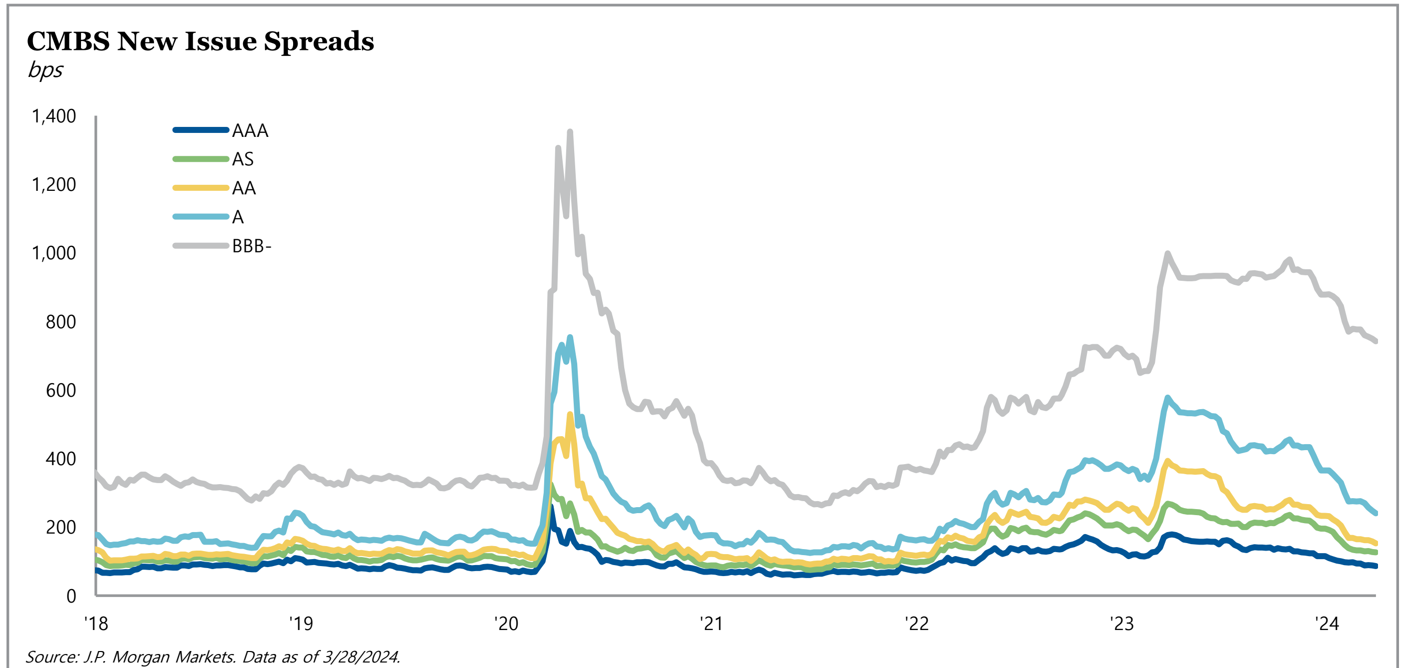
In summary, the CMBS rally from December 2023 continued throughout the first quarter despite the stall in broader interest rate cuts. We expect spreads will continue to tighten, as there is strong demand for new issue bonds with tight underwriting standards, and CMBS remains cheap to alternative structured products. Additionally, large money managers that have been avoiding commercial real estate risk are starting to reemerge in the market.



In the first quarter, the overall CMBS special servicing rate increased primarily due to an uptick in the transfer of office loans.



CMBS issuance was off to a healthy start in the first quarter, and we expect increased volume moving forward, as capital markets have reopened for commercial real estate financing.



CMBS spreads tightened across the capital stack.

TJ Durkin
Head of TPG AG Structured Credit & Specialty Finance

Yong Joe
Co-Portfolio Manager, Structured Credit

David Busker
Portfolio Manager, Commercial Real Estate Debt

For more information on TPG AG Structured Credit & Specialty Finance, click here.

Middle Market Direct Lending

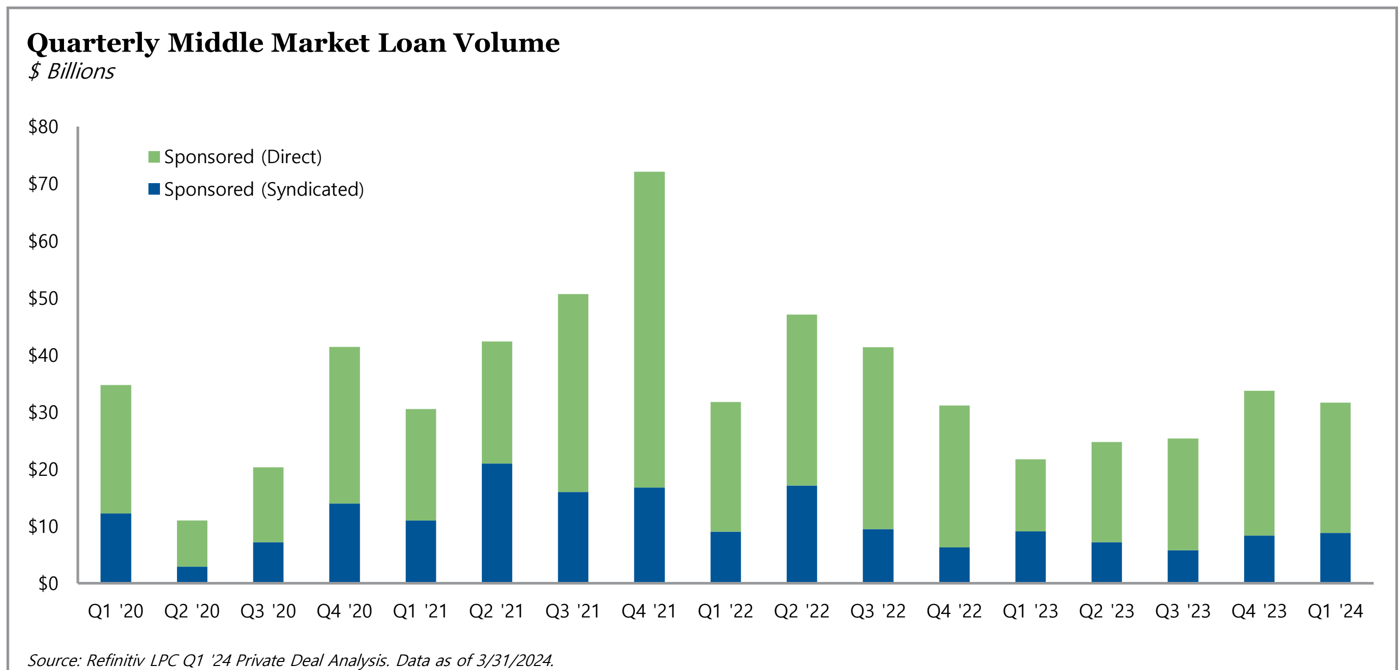
Total sponsored middle market volume, including direct and syndicated activity, amounted to $32 billion in the first quarter of 2024 – down 6% quarter-over-quarter but up over 45% year-over-year. The increase in volume was driven by direct lending, which was up over 80% year-over-year. Private credit continued to be the preferred source of financing, with the ratio of direct lending to syndicated volume standing at 2.6x. M&A activity in the lower middle market (LMM) increased 12% quarter-over-quarter, while core and upper middle market volumes decreased by 30% and 40%, respectively. While first-lien loans continued to account for the largest amount of financing in the middle market, unitranche structures are gaining popularity, as evidenced by a 73% increase year-over-year.

Terms for direct lender-led deals continued to be favorable during the first quarter, as evidenced by the consistent yield premium for middle market deals over large corporate deals, which remained elevated but flat with the fourth quarter at 265 basis points. All-in yields on first-lien term loans remained attractive at around 12%, although the direction of yields varied by company size. Spreads tightened across the direct lending market, with unitranches compressing the most – moving approximately 30 basis points. The healthcare sector led the charge, breaking a 12% all-in yield, followed by technology at 11.8% and business services at 11.7%.

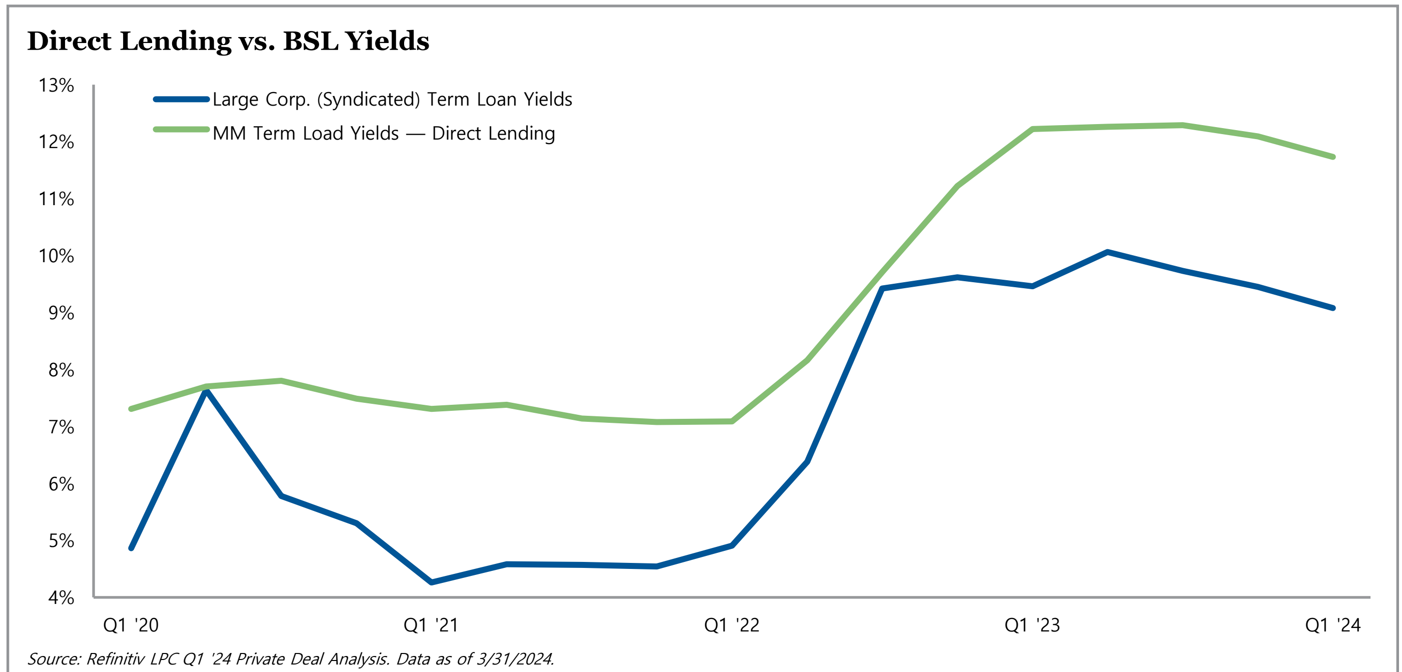
Direct lenders remained disciplined on leverage levels, with leverage tightening across all market segments. Furthermore, equity contributions for middle market LBOs returned to a peak of 62%, which was last reached in the first quarter of 2023. Despite concerns that borrowers are facing challenges due to sustained higher interest costs, interest coverage ratios generally remained flat quarter-over-quarter, decreasing less than 10 basis points to just under 2.0x.

The annualized private credit default rate increased slightly in the fourth quarter of 2023, up 20 basis points to 1.6%. However, default rates across the middle market remained muted, driven by a rate of less than 1% for LMM companies – the lowest LMM level recorded since reporting of the metric began in the first quarter of 2020. Comparatively, default rates for core and upper middle market companies ended 2023 north of 2%, with the core middle market default rate decreasing 30 basis points quarter-over-quarter and the upper middle market rate nearly doubling.

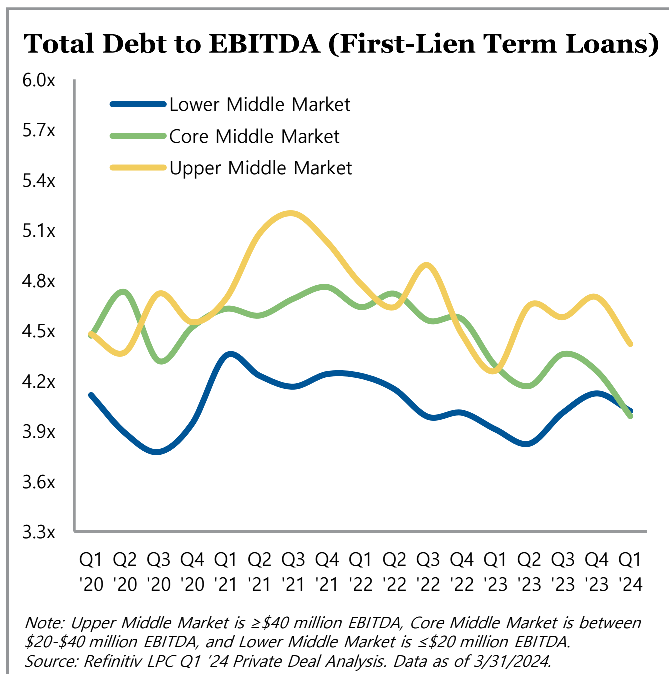
Fundraising activity in the U.S. direct lending market was off to a stronger start to the year than in 2023. According to Preqin data, nine funds focused on senior debt closed in the first quarter with nearly $8 billion raised, versus two funds for a total of $2 billion raised in the first quarter of 2023. According to *Private Debt Investor*'s "LP Perspectives 2024 Study," more than 50% of investors surveyed are seeking to allocate to existing managers rather than expanding their manager roster.



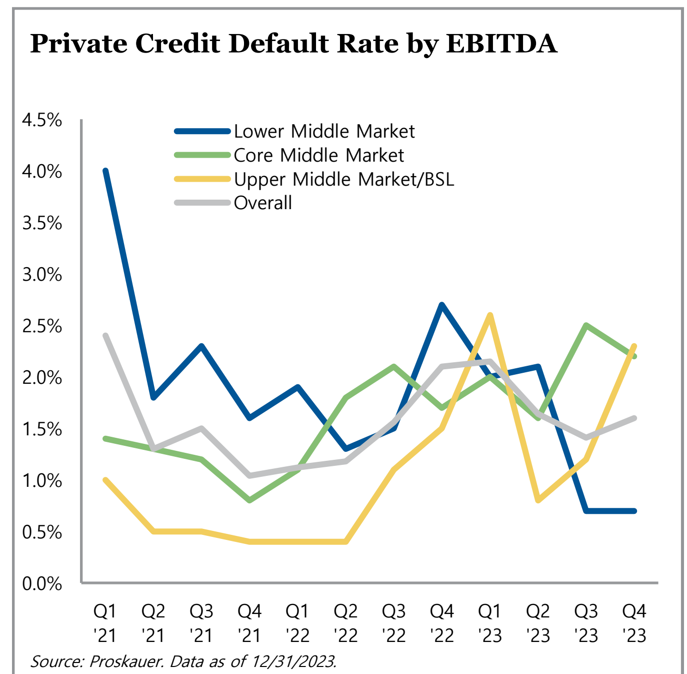
U.S. sponsored middle market loan volume totaled $32 billion in Q1 2024, representing an increase year-over-year.



The direct lender yield premium over large corporate deals remained elevated, at over 260 basis points in the first quarter of 2024.



Total leverage remained conservative across all market segments in the first quarter of 2024.



Private credit default rates across the mid-market remained muted at the end of 2023, with the lower middle market default rate below 1%.

Trevor Clark
Head of TPG AG Middle Market Direct Lending

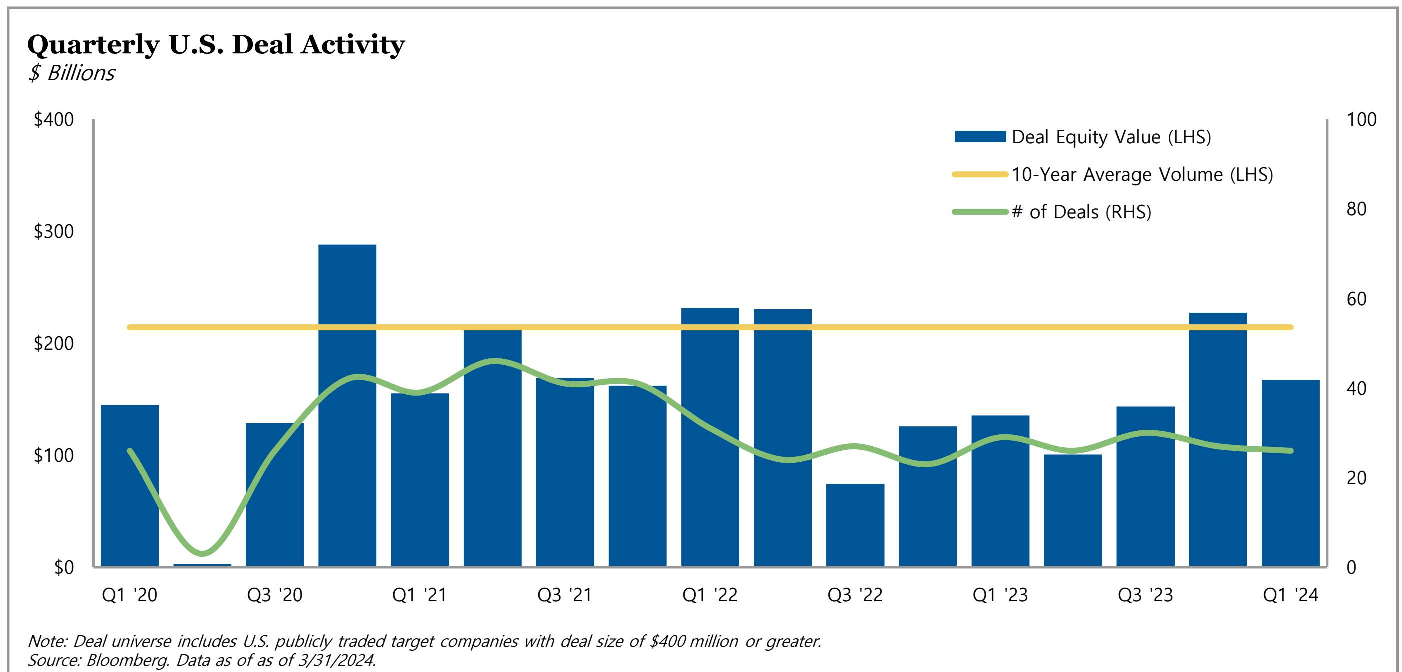
For more information on TPG AG Middle Market Direct Lending, click here.

Merger Arbitrage

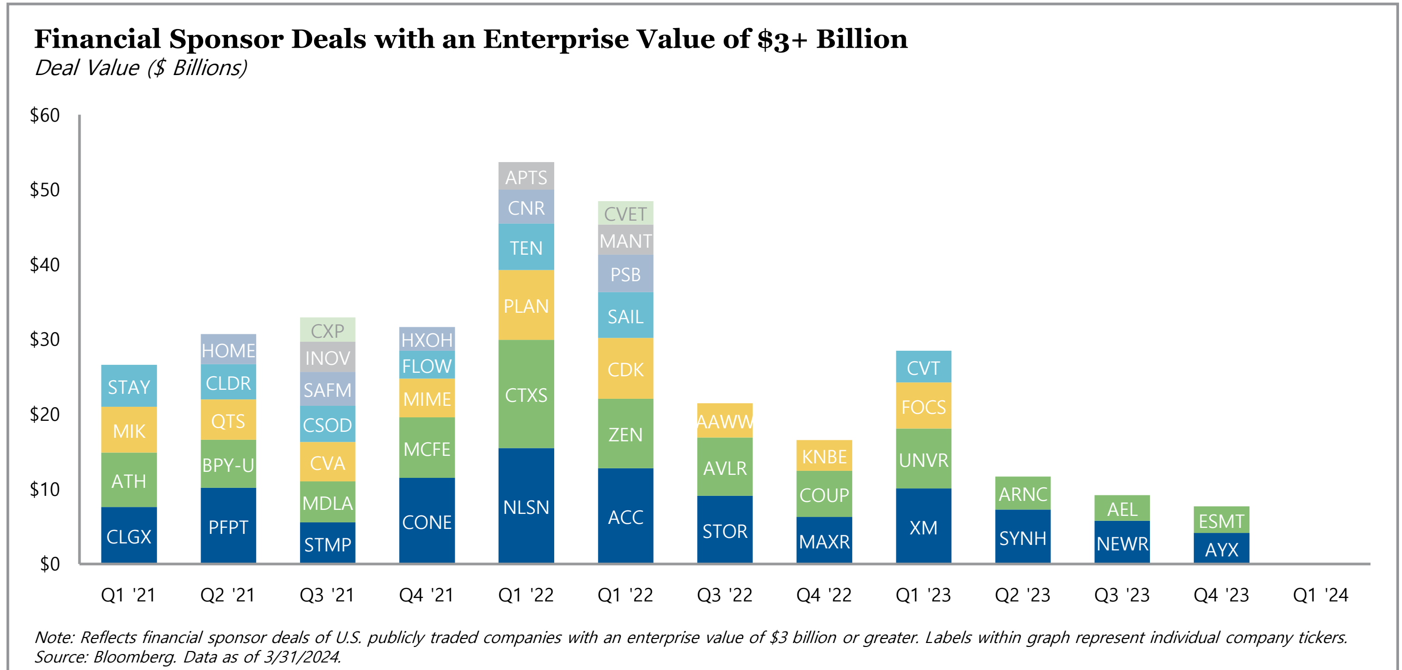
In the first quarter of 2024, U.S. M&A volume increased 28% year-over-year aided by two $35 billion deals, with Discover Financial Services agreeing to merge with Capital One Financial Corporation and Synopsys, Inc. announcing an acquisition of Ansys, Inc. While not accounting for any of the top three deals this quarter, energy and healthcare remained the most active sectors and together represented over 50% of the top ten deals during the period. Financial sponsor activity remained muted, declining to 4% of total deal value and not accounting for any of the top ten deals for the second consecutive quarter.

At quarter-end, aggregate U.S. deal value increased to $341 billion, and the total arbitrage profit pool grew to $27.9 billion. While the average adjusted annualized spread in the U.S. deal universe tightened from 11.4% to 9.7% in the first quarter, the market-cap-weighted adjusted gross spread widened to from 7.8% to 9.1%. Although the quarter saw PGT Innovations receive a topping bid from MITER Brands and Thoma Bravo bump up its purchase price for Everbridge, Inc., regulatory actions again dominated investor discussion during the period. The year started off with three deal terminations: Amazon had to abandon its pending acquisition of iRobot after running into European Commission concerns; Avangrid, Inc. terminated its three-year pursuit of a merger with PNM Resources; and JetBlue Airways abandoned its acquisition of Spirit Airlines after a federal judge blocked the proposed deal. These three deals were long-dated carryovers from 2023, thus their unfavorable terminations did not surprise arbitrage investors. Additionally, the FTC sued to block Kroger's acquisition of Albertsons Companies, an event the market had anticipated for many months.

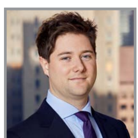
U.S. antitrust agencies appeared to be sticking to their 2023 playbook through the first quarter of this year. The FTC continued its pattern of issuing Second Requests to deals that many market participants believe historically would have easily cleared and closed, with such delays deterring some from transacting. Much like last year, these regulatory actions have resulted in deals that otherwise likely would have closed in the first quarter being pushed, with decisions not being expected until late in the second quarter or back half of 2024. Despite the regulatory environment, U.S. M&A continued its recovery toward the long-term average volume of activity.



The gradual recovery in M&A continued in Q1 2024, but M&A volume continued to run below the long-term average.



Despite record investable cash and the talk of more mega-funds being raised this year, in Q1, financial sponsors failed to announce a $3 billion deal for the first time since the COVID-19 shutdown in Q3 2020.



Mark Wojtusiak
Head of TPG AG
Merger Arbitrage

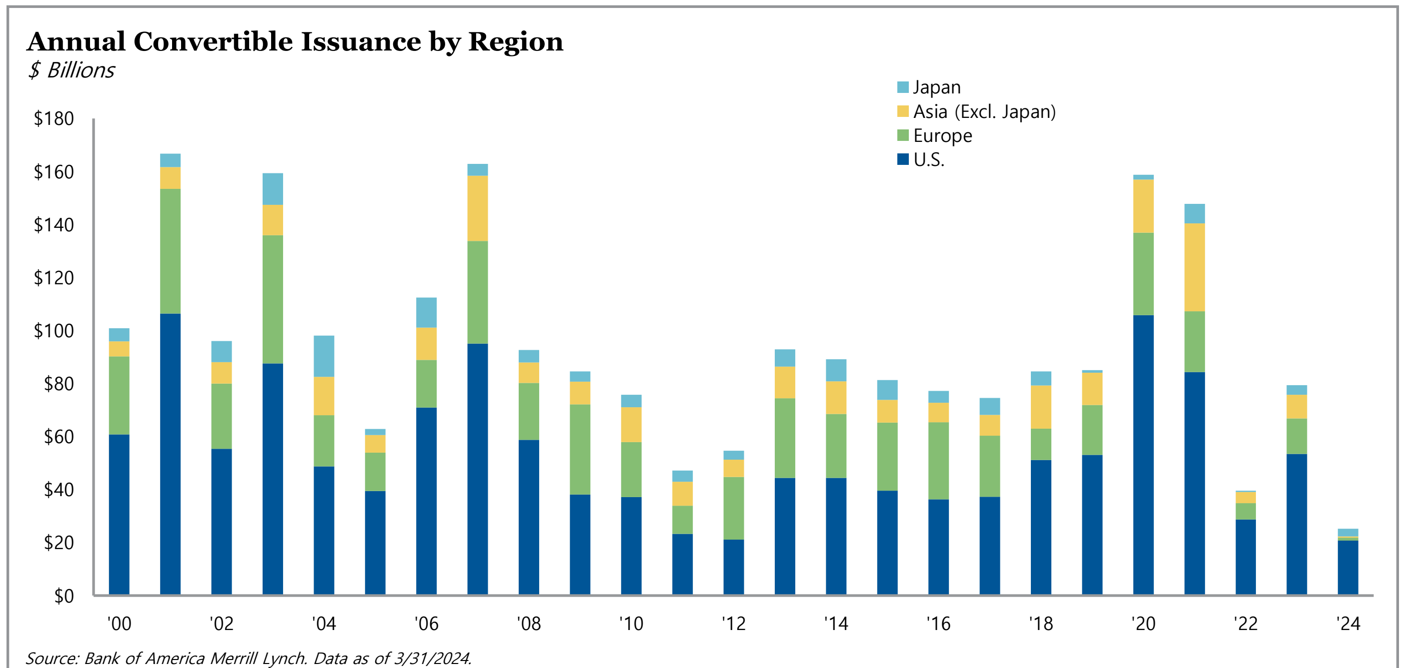
For more information on TPG AG Merger Arbitrage, click here.

Convertible Arbitrage

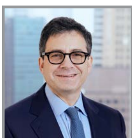
Risk assets continued to build on the strong fourth quarter of 2023, with global equities up over 10% in the first quarter of this year. A string of strong economic readings supporting a soft-landing narrative carried a number of underlying equity markets to all-time highs. However, more persistent inflation led investors to price in fewer cuts by the Fed, which led to a rate selloff, which weighed on bond performance. The BofA Global 300 Converts Index was up 3.6% led by Japan and Europe, outperforming other fixed income assets in the quarter.

Global issuance was $25.2 billion, heavily skewed to the U.S., and about 60% of proceeds have been used to refinance outstanding debt in the face of high rates and a looming maturity wall. A key reason for the strong issuance in the convertible bond market is the cash interest savings for issuers versus conventional debt, which averaged 550 basis points of savings in the first quarter. Overall, there was a net reduction in supply of $761 million in the first quarter, driven by $4.7 billion of bond redemptions in Europe. The limited supply in Europe has supported secondary market valuations. We are closely monitoring Japan issuance, which has been strong, but new issue pricing is not as attractive compared to the U.S. and Europe. At the end of the first quarter, the global convertible market size was $368 billion.

A theme we continue to watch is the impact of the rate increases from 2022 and 2023 on the cash interest costs of even the highest quality issuers. In the first quarter, investment grade issuers that came to the converts market saved 175 basis points on average relative to a conventional debt alternative. In fact, this dynamic has brought first-time issuers to the market, representing over 40% of the market in the first quarter.



Global new issuance picked up in the first quarter of 2024, driven by the U.S.



Gary Wolf
Head of TPG AG Convertible Arbitrage

For more information on TPG AG Convertible Arbitrage, click here.

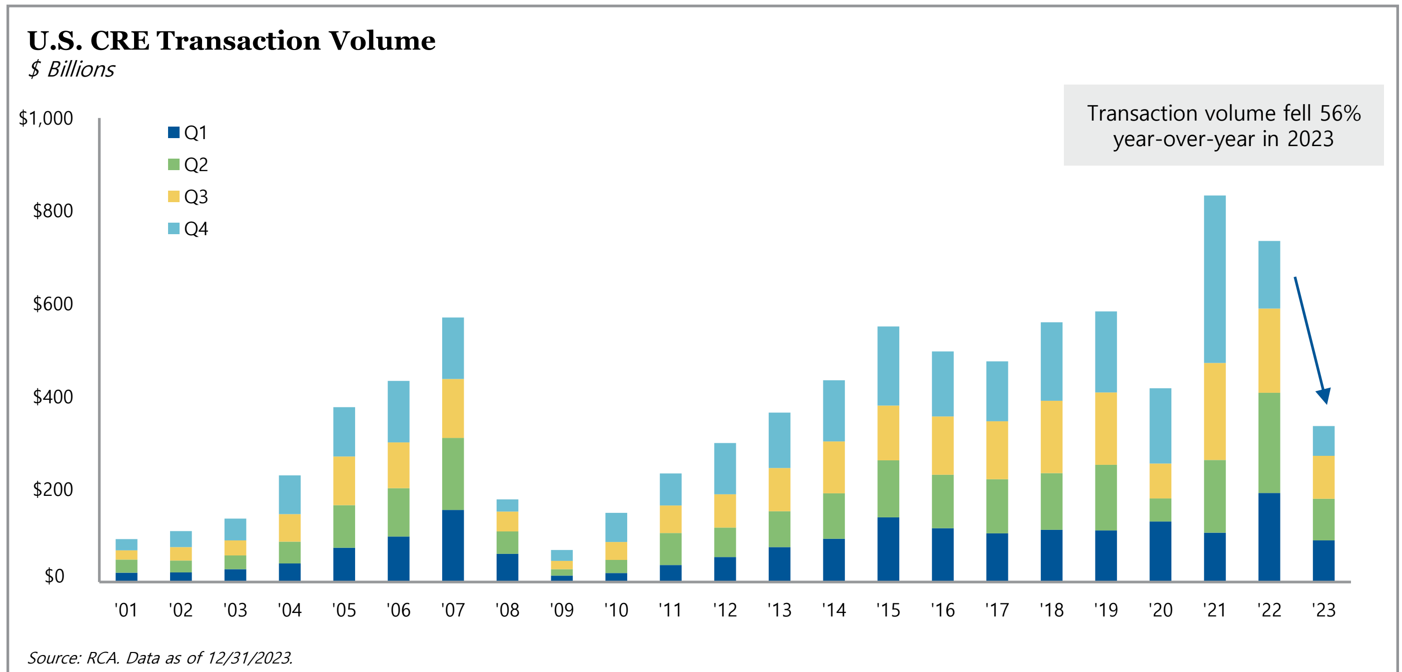
U.S. Real Estate

The U.S. economy continued to demonstrate resilience in the first quarter, with steady GDP and employment growth. Inflation – while cooling from its 2022 peak – remained elevated, and there continues to be significant uncertainty around the timing and pace of the Fed's rate cutting cycle. The consensus view of a soft landing has also been clouded by emerging risks, such as those in the consumer sector, where credit card and auto loan delinquency levels have increased from their pandemic-era lows.

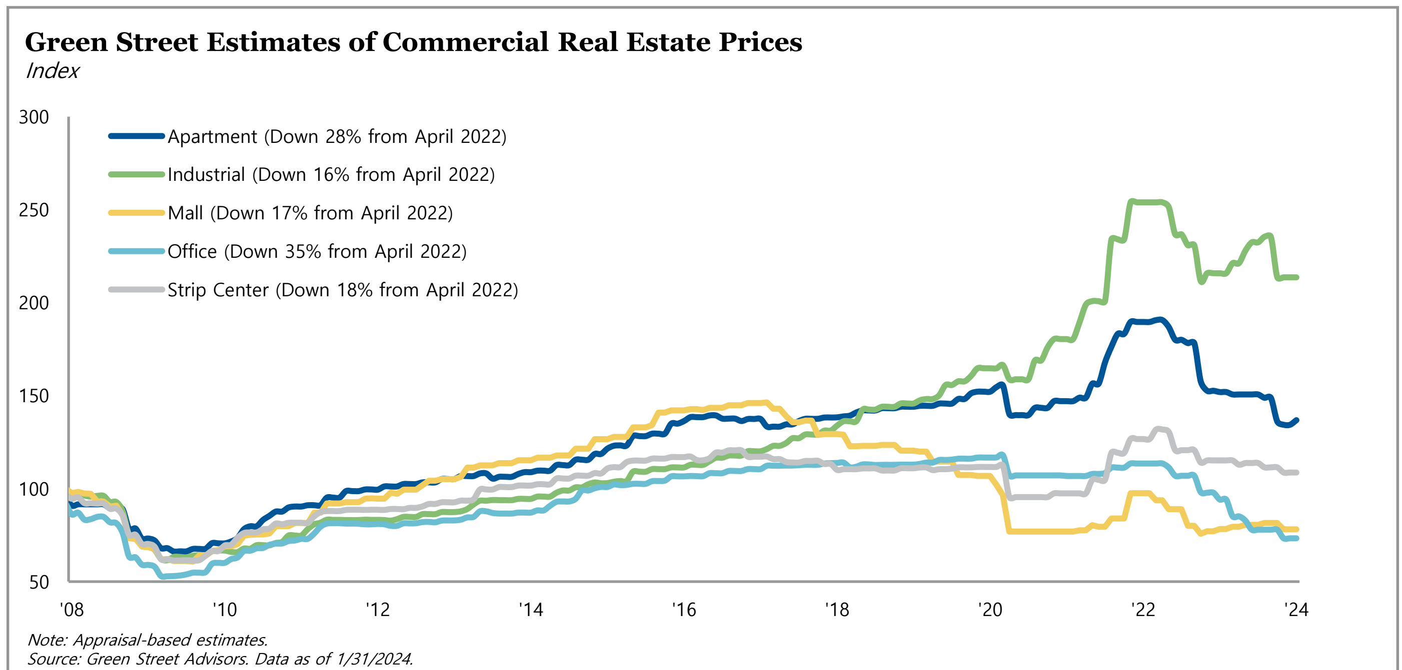
The uncertain macro backdrop contributed to a 56% year-over-year decline in overall transaction volume in 2023, as buyers navigated heightened borrowing costs and limited financing options. This trend continued into 2024, with February data indicating a 47% year-over-year decrease in transaction volume. Based on this limited transaction data, pricing has remained depressed relative to its 2022 peak, though the rate of decline in pricing seems to be moderating and there is significant dispersion across sectors. Fundamentals remained relatively stable across most sectors other than office, with generally manageable supply levels; however, there are pockets of overbuilding in multifamily and industrial in certain geographies, so market and submarket selection remains critical. We expect the sharp curtailment of the forward delivery pipeline due to escalating construction costs and financing constraints to support fundamentals in 2026 and beyond.

Commercial real estate (CRE) loan origination volume in the first quarter of 2024 was down more than 48% from the first quarter of 2023, as elevated base rates and more stringent lending standards continued to significantly hamper originations. Challenges in lenders' existing loan books also contributed to a pullback in originations, as delinquencies have steadily risen since the third quarter of 2022 and are nearly triple the low recorded in the fourth quarter of 2019. Smaller banks have significantly higher exposure to CRE loans as compared to their larger counterparts, so we expect they may be more meaningfully impacted by these non-performing CRE loans. With $2 trillion of commercial mortgages set to mature over the next 36 months – approximately 43% of total outstanding loans – we believe there will be a growing opportunity to provide rescue capital or acquire high-quality assets at reset valuations.

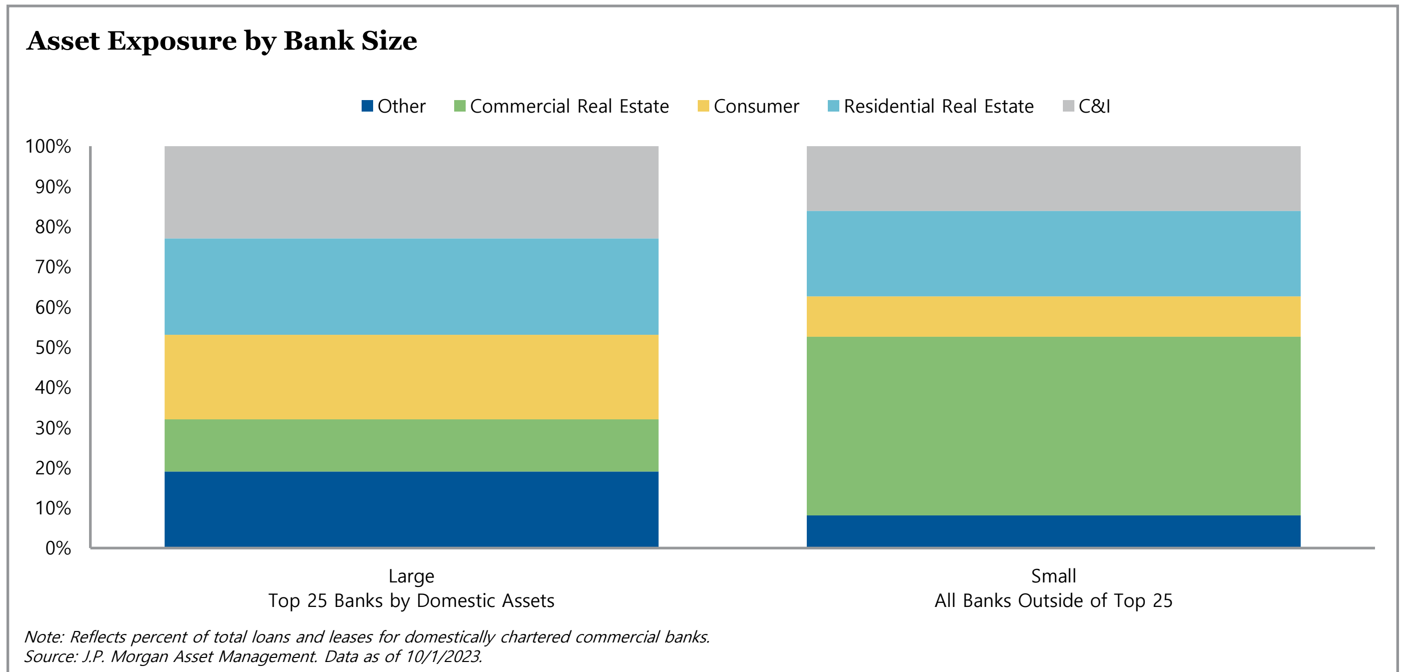
The Fed has signaled its interest rate hiking campaign is likely finished, but there continues to be significant uncertainty around the timing and pace of rate cuts, particularly as inflation remains above the Fed's target.



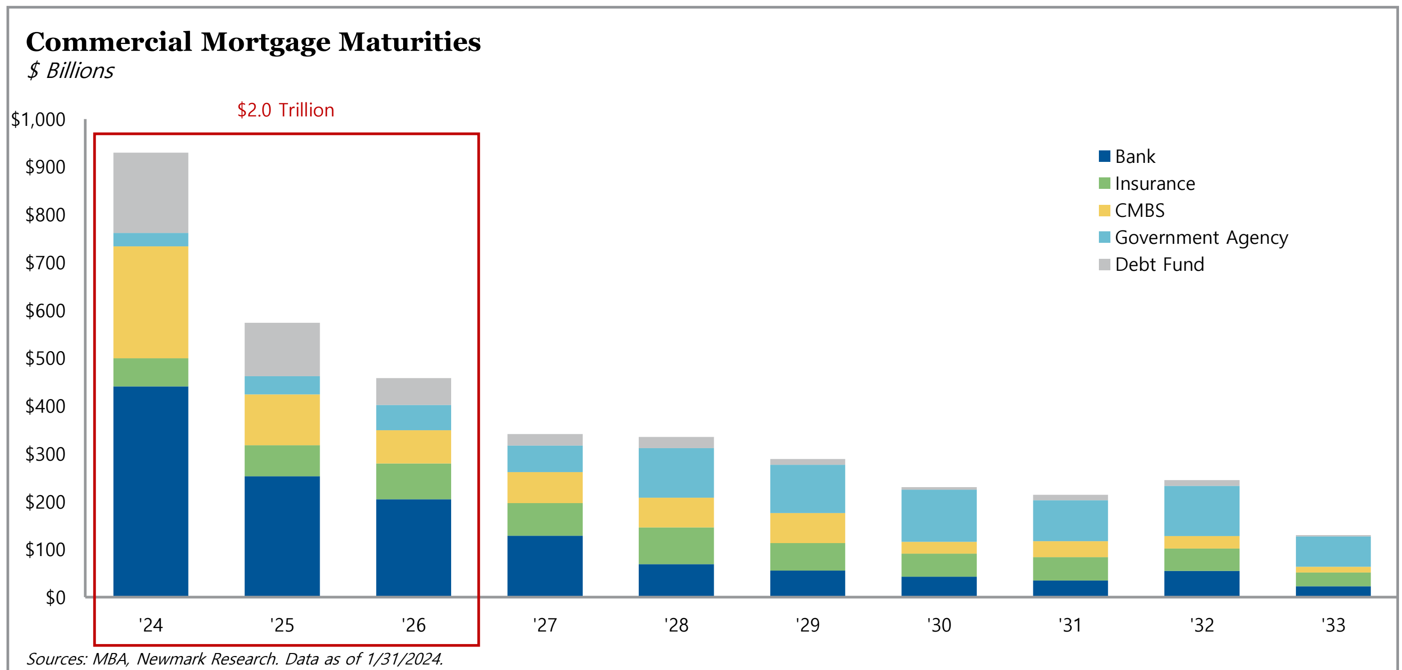
After reaching peak levels in 2021 and 2022, commercial real estate transaction volume has experienced a notable decline as buyers grapple with increased borrowing costs, limited financing, and an uncertain macroeconomic landscape.



U.S. commercial property prices were down from their 2022 peak, with variation in valuation declines across asset classes.



Commercial real estate loan exposure is significantly higher at smaller banks compared to their larger counterparts.



As loans mature, we expect increased borrowing costs and reduced proceeds for replacement financing to create distress and voids in capital structures, which will need to be filled by new equity or rescue capital.

Reid Liffmann
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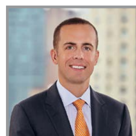

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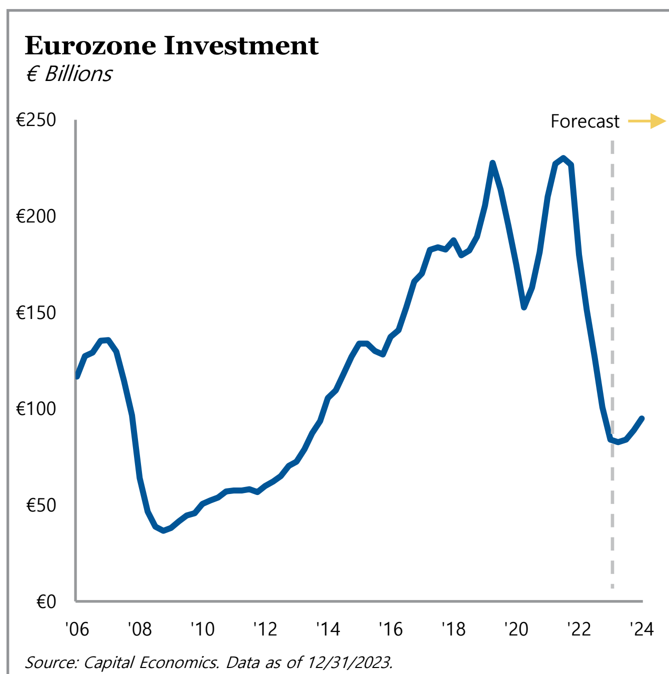
Europe Real Estate

The effects of higher interest rates have continued to impact European economies and real estate markets. Eurozone GDP remained flat in 2023 and will likely stagnate in the first half of 2024. The European Central Bank (ECB) decided to keep interest rates at the record-high of 4% in April, defying market expectations of a rate cut early this year. However, with headline inflation easing to 2.4% in March – closer to the ECB's 2% target – it is possible that the central bank will cut rates in the second half of the year.

Given elevated inflation, interest rates, and a tight lending market, real estate transaction volume was the lowest it has been in over a decade in full year 2023. Overall, annual investment fell nearly 50% year-over-year, with a peak-to-trough decline since mid-2022 of approximately 65%. Muted transaction activity and expanding cap rates have led to declining prices across virtually all real estate sectors; however, the fourth quarter of 2023 showed signs of improvement, as volume notably increased in larger markets such as Spain, France, and Italy. That being said, with interest rate cuts likely delayed, bond yields edged up, which we expect will put further pressure on valuations in the near-term.

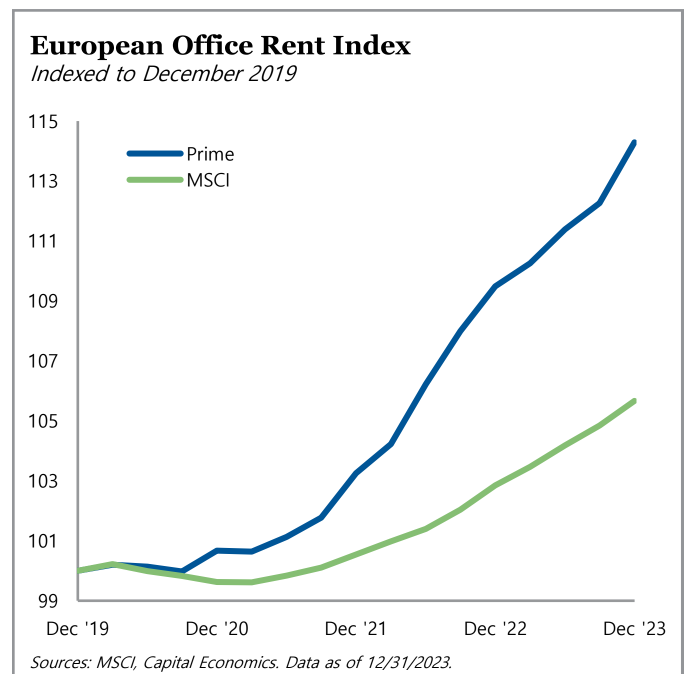
Unsurprisingly, European office leasing remained weak and full-year 2023 data shows take-up declined 15-20%. Prime office assets continued to outperform, as occupiers remained focused on location and quality. This has been reflected in rental performance, as average office rents have increased 4.5% since 2019, while prime rents have grown at twice that rate – deepening the polarization between prime and non-prime assets. In multifamily, demand for rental accommodations has been bolstered by rising rates across Europe, and the sector continues to attract institutional investment.

With potential interest rate cuts on the horizon – albeit delayed – we will likely see an increase in liquidity in the second half of 2024; however, we also expect the overall recovery to be sluggish as real estate owners adjust to a structurally higher rate environment. In this environment, credit products can offer a competitive and compelling yield compared to core commercial property, and as a result, we have been seeing some investors rotate out of core real estate, particularly through redemptions from open-ended core funds. This rotation may be structural and might mean liquidity for commercial real estate remains impaired compared to previous cycles. Combined with valuation drops and rapidly approaching 2024 and 2025 debt maturities, we have started to see stressed and distressed sellers emerge, and we expect these factors will create significant opportunities to purchase high-quality assets at discounted prices.



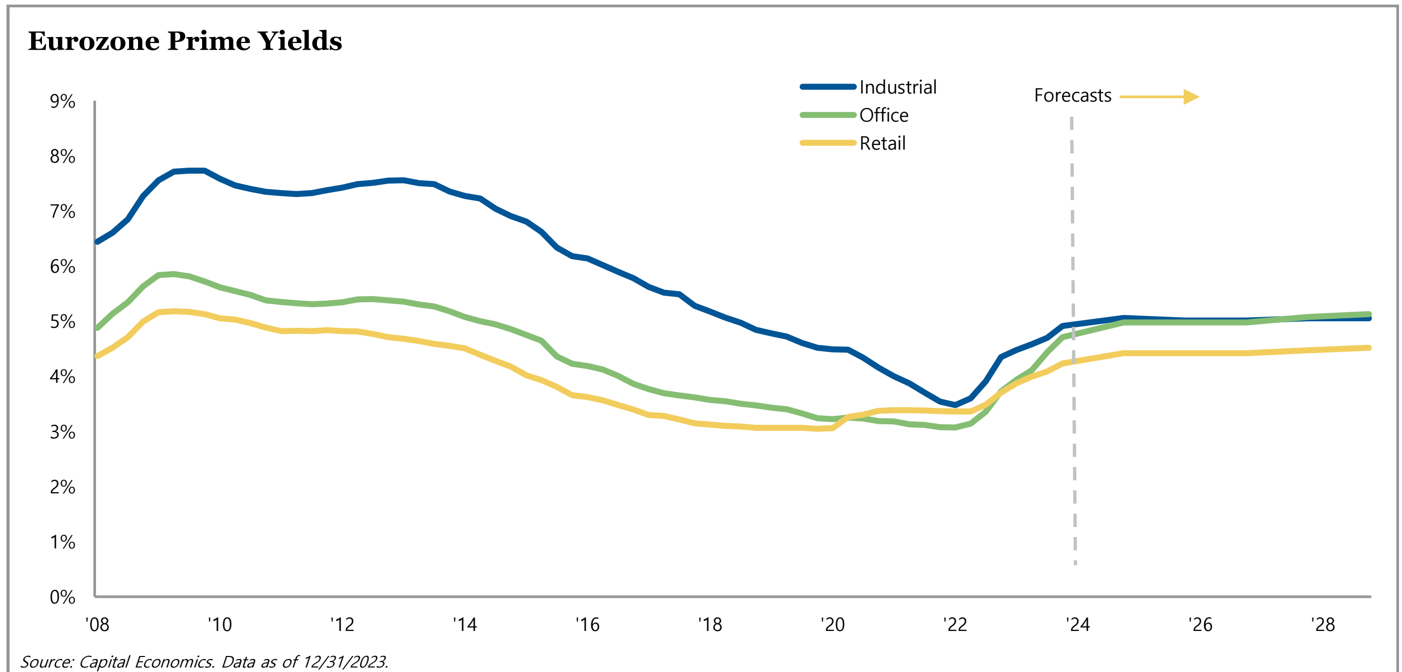
Source: Capital Economics. Data as of 12/31/2023.

There has been a significant decline in transaction volume since the peak recorded in mid-2022; however, Q4 2023 brought increased activity.

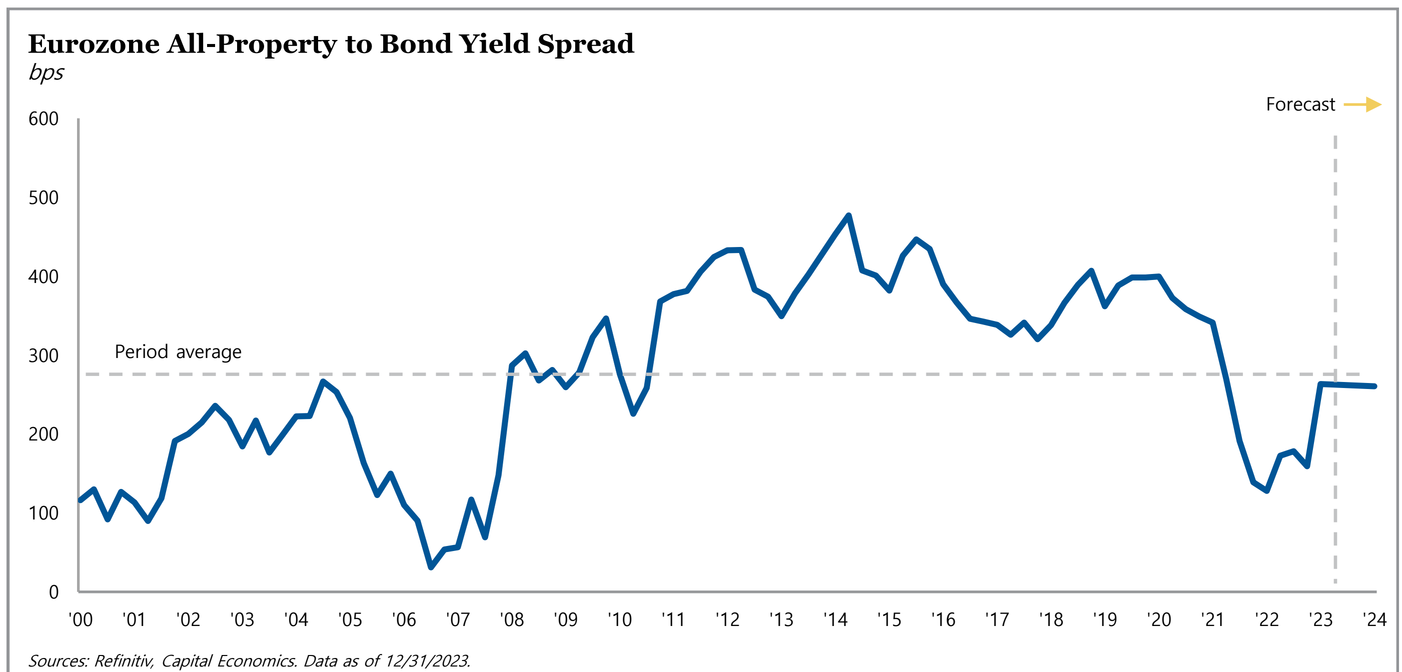


Sources: MSCI, Capital Economics. Data as of 12/31/2023.

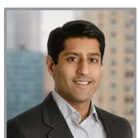
Prime office rents have outperformed since the pandemic and continue to diverge from non-prime assets.



Expanding cap rates have led to significant valuation declines across nearly all sectors.



Property-to-bond spreads have narrowed compared to the 20-year average, causing some investors to rotate out of core commercial real estate investments.



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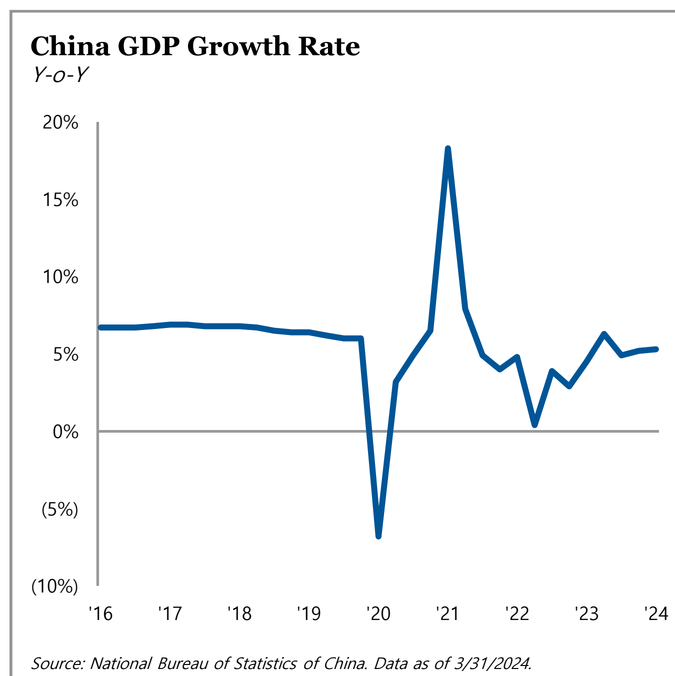
Asia Real Estate: China

Despite geopolitical tensions and the impact of overseas interest rate hikes, China's economy continued to gain traction, growing 5.2% year-over-year in the fourth quarter and 5.2% for the full year of 2023, meeting the central government's growth target of 5.0%. Since reopening from zero-COVID in December 2022, China has shifted its focus to economic growth and rolled out a series of accommodative macroeconomic policies. The People's Bank of China cut the reserve requirement ratio by 50 basis points in February 2024, following two 25-basis-point cuts in September 2023 and March 2023. The five-year loan prime rate (LPR) was lowered by 25 basis points in February 2024, following an earlier 10-basis-point cut for one-year LPR in August 2023 and another 10-basis-point cut for one- and five-year LPR in June 2023. For the full year 2023, exports increased 0.6% year-over-year and value-added industrial output rose by 4.6%. Domestic retail sales increased 7.2% in 2023, and online retail sales increased 8.4%. China remains highly focused on developing its advanced manufacturing sector, particularly in industries such as life sciences, integrated circuitry, and new energy. While total fixed-asset investment activity grew only 3.0% year-over-year in 2023, fixed-asset investment in high-tech industries grew 10.3% year over-year.

The Shanghai industrial and logistics market improved in the fourth quarter, with net absorption of 234,000 square meters. New supply was delivered in the logistics market during the fourth quarter, adding approximately 285,000 square meters. The recovery of demand led to marginal growth in vacancy to 15% during the quarter, while industrial rents stayed flat.

The multifamily sector, particularly in leading cities such as Beijing and Shanghai, maintained strong and sustainable demand attributable to significant domestic migration and affordability of for-sale housing. To bolster this trend, the government has introduced a series of supportive policies, such as offering preferential tax treatment for the conversion of commercial properties into multifamily.

In terms of overall market activity, year-to-date transaction volume totaled RMB 206.3 billion – down 13% year-over-year due to the cautious investor sentiment. Logistics, multifamily, and business parks remained the most prevalent investment asset classes.



China's GDP improved modestly in the first quarter of 2024.

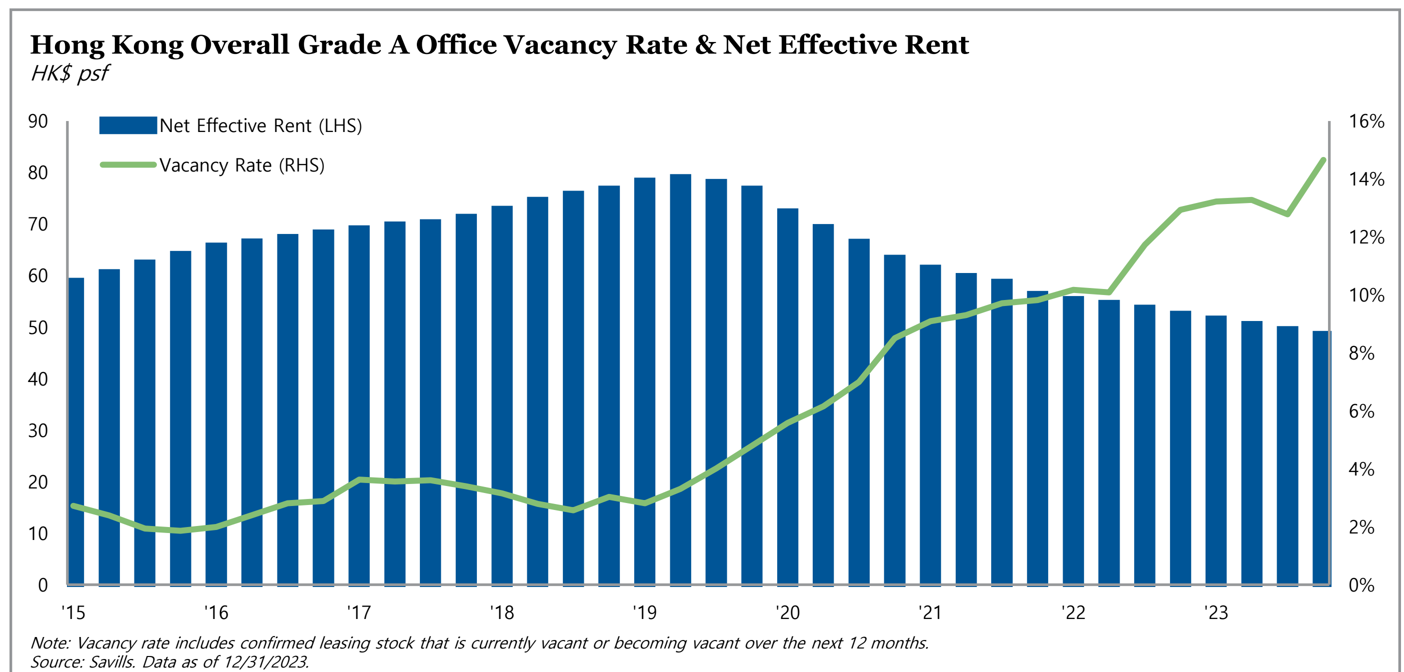
CNY values weakened in the first quarter of 2024.

Asia Real Estate: Hong Kong

In the wake of the pandemic, Hong Kong's economy experienced a resurgence in 2023 – expanding 4.3% year-over-year in the fourth quarter and 3.2% for the full year – driven by the strong recovery of inbound tourism and private consumption. Total exports declined in 2023, falling 10.3% year-over-year amid the challenging global market environment. Total exports of services grew substantially by 21.2% in 2023. Private consumption improved, increasing 7.3% year-over-year in 2023 alongside the continued economic recovery. In February 2024, the government announced its 2024-25 budget focusing on measures to boost economic and investment activity, including the relaxation of stamp duty policies to improve residential property market liquidity and raising the loan-to-value caps for both residential and non-residential mortgage loans.

The residential rental and student housing sectors have benefitted from the influx of foreign talent, expatriates, and non-local university students to the city. As of November 2023, the talent admission program established by the Hong Kong government had received more than 205,000 applications with approximately 127,000 approved. Additionally, roughly 90,000 professionals arrived in Hong Kong in 2023, nearly three times the annual target for this new program. The number of non-local students in Hong Kong has increased 17.3% from 2021/22 to 2022/23, resulting in the non-local student ratio increasing from 22% to 25% during the same period. Within the 2024-25 budget, the government has introduced additional initiatives to attract professional talent, including relaxation of visa policies and an increase in the admissions quota of non-local students to local universities from 20% to 40%, which is a dramatic change.

In the fourth quarter of 2023, residential prices retreated 6.4% year-over-year and 6.1% quarter-over-quarter – remaining below the high recorded in September 2021. This decline is mainly attributable to smaller residential units – decreasing by 6.0% as compared to the 4.9% price decline for larger units. On the other hand, mass residential rents grew by 6.2% in 2023, and townhouse rents grew by 8.6%. Commercial real estate investment transaction volume reached HK$40.4 billion for the full year of 2023, just 53% of the previous year's total, as the asset class has remained out of favor. Investment demand in the fourth quarter was largely supported by end-users, accounting for 57% of the quarterly transaction volume. The office sector continued to remain weak, both in terms of tenant demand and investor interest. As of December 2023, Hong Kong's office vacancy increased slightly to 14.7%, while rents fell by 1.8% in the fourth quarter.



Hong Kong's office vacancy increased slightly to 14.7%.

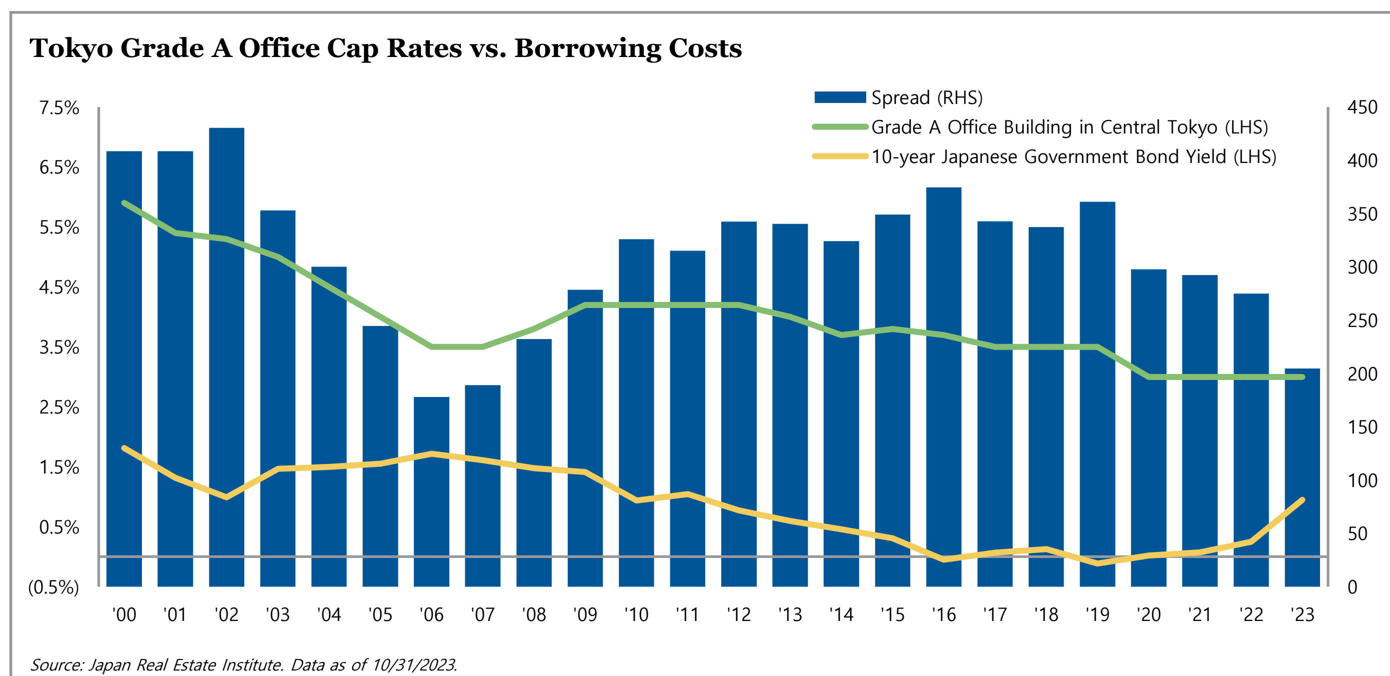
Asia Real Estate: Japan

In the final quarter of 2023, Japan's real GDP grew 0.4% quarter-over-quarter as strong capital expenditures helped the economy avoid a technical recession. Japan's labor market remained resilient, with unemployment at 2.4% as of January 2024. The inflation rate decreased slightly to 2.0% during the same time – a continued decline from the 41-year high of 4.2% recorded exactly a year ago – and real wages fell 0.6% year-over-year, continuing their 22-month decline.

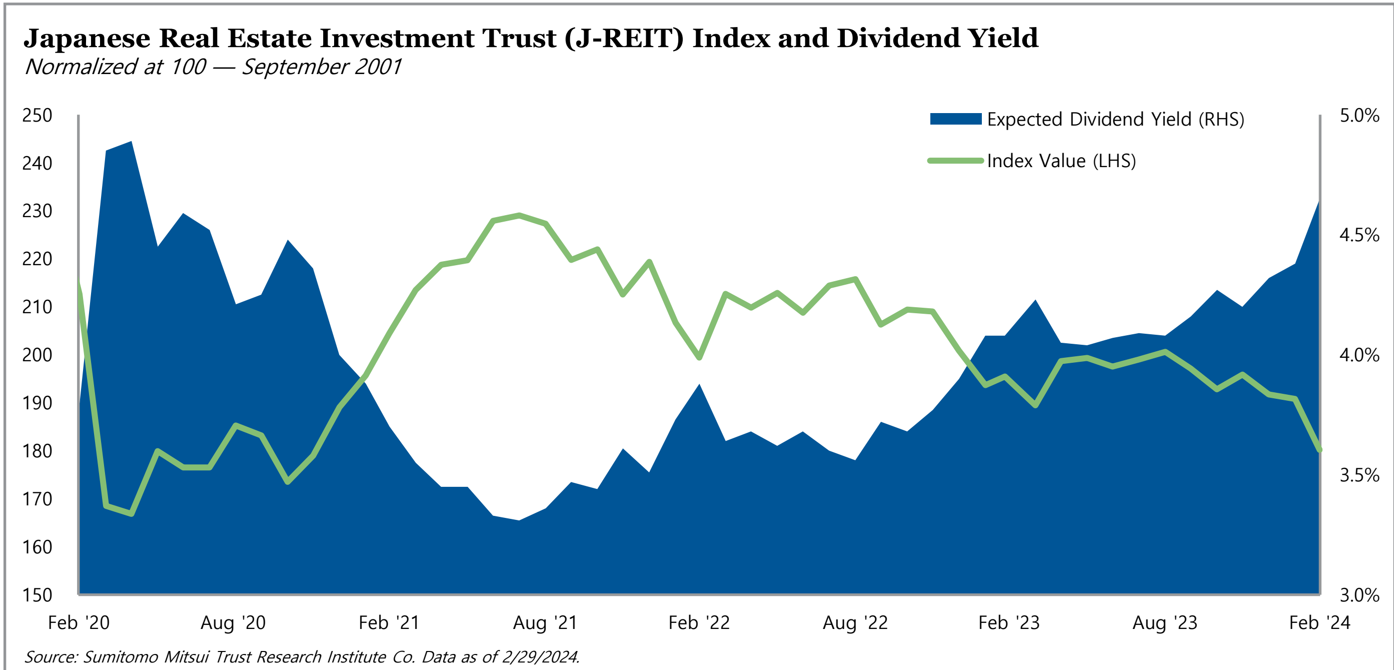
Office real estate fundamentals strengthened in the fourth quarter, supported by unwavering tenant demand. All-grade vacancy rates decreased from 5.2% to 4.7% in Tokyo and from 3.3% to 2.9% in Osaka quarter-over-quarter. Tokyo also experienced a 0.9% decrease in the Grade A office vacancy rate during the quarter, down to 5.7%, with net absorption of 3 million square feet in newer buildings – roughly double the average seen in recent quarters. We expect office demand to remain stable, with vacancies continuing to be filled by relocations from suburban areas, consolidations, expansions, and demand from office upgrades.

Logistics vacancy for large multi-tenant facilities in greater Tokyo rose from 8.9% to 9.3% quarter-over-quarter, with the delivery of 3.7 million square feet of new supply. In the greater Osaka area, the vacancy rate for large multi-tenant facilities increased to 6.0%, up 1.5% quarter-over-quarter, due to new supply deliveries; however, for facilities that were built more than one year ago, vacancy was a mere 0.2%, as tenants prefer to sign leases after a property has been delivered rather than during construction.

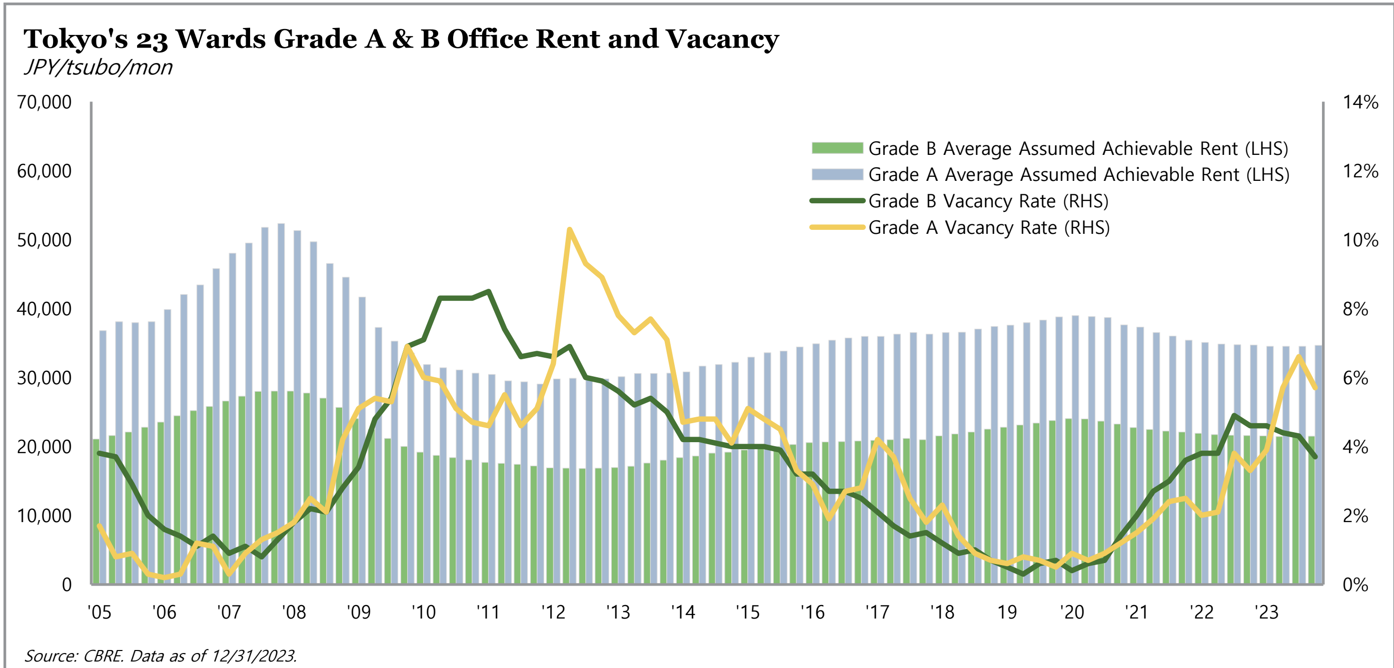
Transaction volume in 2023 was ¥3.8 trillion, down 3% year-over-year. Investments by domestic investors, including Japanese REITs (J-REITs), increased 12%, while foreign investor appetite fell by 28%. The hotel sector experienced the most notable year-over-year growth, increasing by 2.5 times from 2022 to reach ¥529 billion, marking the highest amount in the past five years. The office sector continued to lead in transaction activity, with investment volume of ¥1.1 trillion, driven by strong demand from domestic buyers looking to purchase stabilized assets.



Office cap rate spreads in Japan remained wide despite an uptick in 10-year Japanese government bond yields.



J-REIT performance has declined, resulting in higher yields and limiting J-REITs' abilities to make accretive acquisitions.



Tokyo office vacancy declined as overall market fundamentals strengthened in the fourth quarter of 2023.

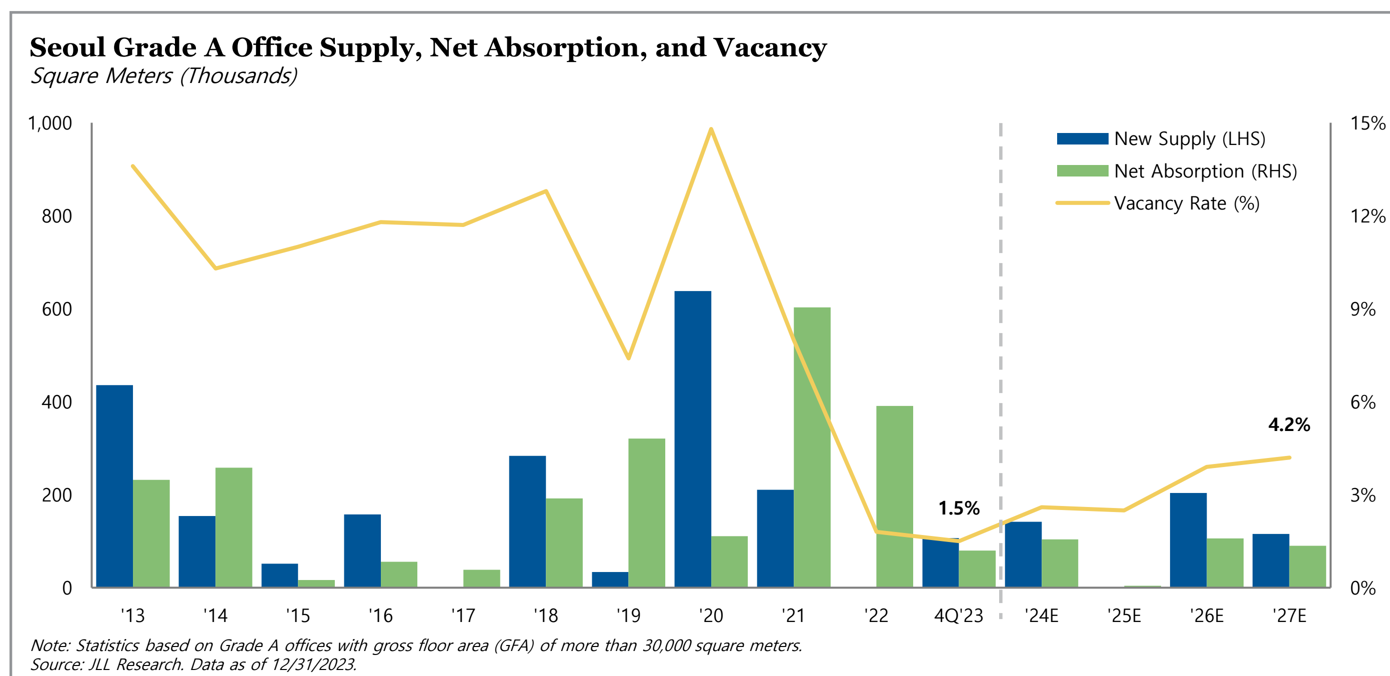
Asia Real Estate: South Korea

The Bank of Korea (BoK) held its base rate at 3.50% in the fourth quarter, leaving it unchanged since January 2023. Consequently, the rate gap between South Korea and the U.S. stands at an all-time high of 200 basis points, as the U.S. Federal Reserve kept its benchmark interest rate steady following a 25-basis-point increase in July 2023. In the fourth quarter, South Korea's GDP continued its economic growth of 0.6% quarter-over-quarter. Looking ahead, the BoK has projected 2024 economic growth to reach 2.1% while inflation is expected to moderate to 2.3%.

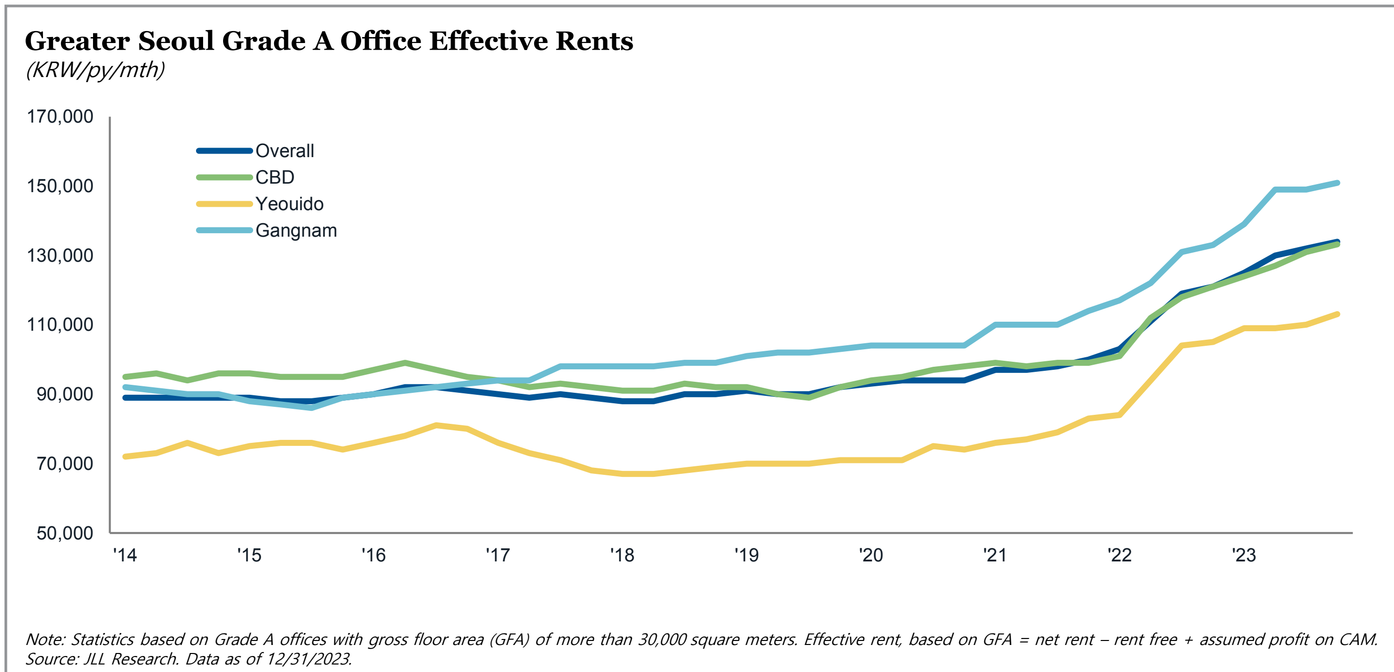
On the real estate front, office cap rates stood at 4.5% in the fourth quarter of 2024 – up 10 basis points quarter-over-quarter. Spreads between prime office cap rates and Korean government bond yields (i.e., 10-year treasury bonds) widened and stood at approximately 130 basis points. This spread widening can be attributed to lower treasury yields, which stood at 3.2% at the end of the fourth quarter – down 80 basis points quarter-over-quarter. Such yield movement was caused by a shift in market expectations, anticipating a potential interest rate cut by the Fed in the upcoming year.

Office fundamentals remained strong backed by robust demand. Prime office vacancy in Seoul decreased to 1.5% at the end of the fourth quarter – down 50 basis points from the previous quarter. With sufficient demand and limited ongoing supply, vacancy rates are projected to remain below 5.0% for the next four years. Additionally, overall office rents increased 10.3% year-over-year, with the Gangnam Business District exhibiting a 13.6% rent growth year-over-year. Investment activity totalled ₩2.4 trillion in the fourth quarter – down 11.9% year-over-year. On a year-to-date basis, transaction volume totalled ₩11.3 trillion – down 32.0% year-over-year, mainly due to investor concerns over rising financing costs.

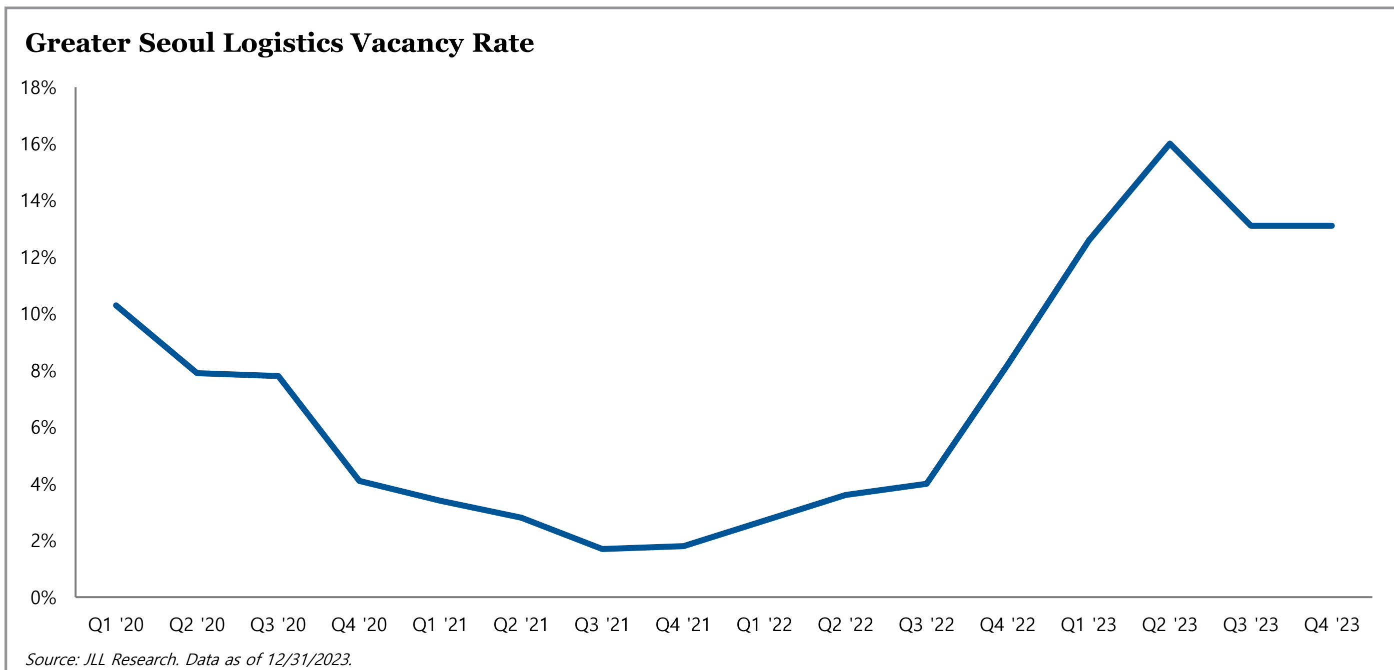
Logistics vacancy in Greater Seoul stood at 13.1% in the fourth quarter – in line with the previous quarter – despite 11.5 million square feet of new supply delivered during the period. Even with the increase in supply, demand for logistics space in Greater Seoul remained strong, with net absorption of over 10 million square feet. According to JLL, the vacancy rates in key logistics submarkets are expected to improve over the next two years, with reduced future supply and resilient demand. Meanwhile, logistics transaction volume amounted to ₩1.1 trillion in the fourth quarter – up 53.1% year-over-year. On an annual basis, transaction volume reached ₩6.4 trillion – down 2.6% year-over-year.



Prime office vacancy in Seoul is near a historical low and is projected to remain below 5%, underpinned by robust demand and limited future supply.



Office rents in Greater Seoul remained robust across all four major submarkets despite concerns of a global economic slowdown.



Logistics vacancy remains high due large-scale supply in recent quarters, but future supply is expected to moderate in the next two years.

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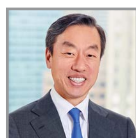
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TPG AG Asia Real Estate

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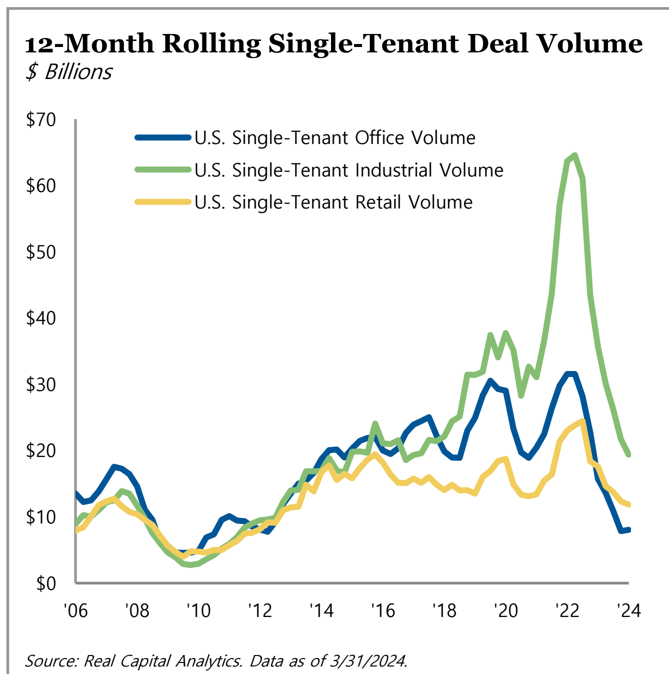
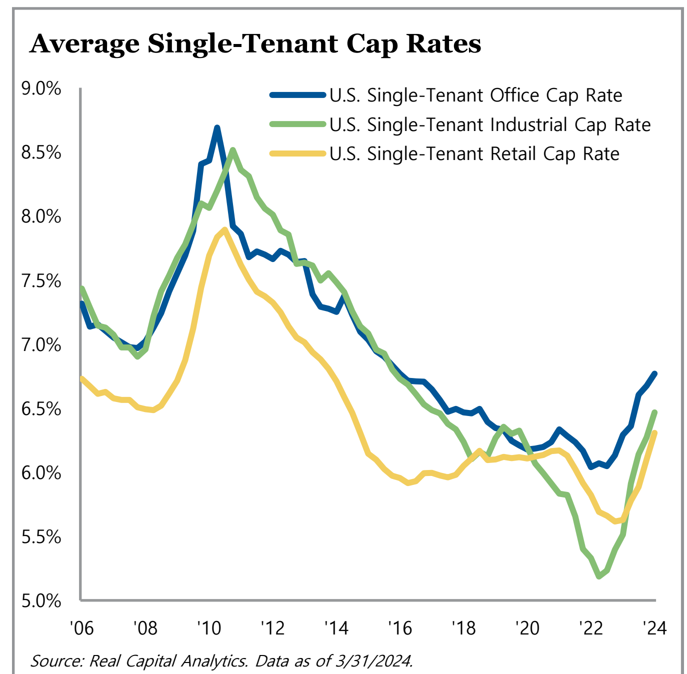
Net Lease Real Estate

U.S. single-tenant transaction volume remained muted in the first quarter of 2024, with trailing 12-month volume totaling $39 billion, according to Real Capital Analytics (RCA). Since the peak in the second quarter of 2022, trailing 12-month transaction volume has declined by 67% and was seen across asset types, with office, industrial, and retail all down by more than 50%. While net lease volume is expected to stabilize more quickly than the broader economy, it remains well short of the investment pace seen in 2020 and 2021. CBRE forecasts investment activity will remain subdued for the remainder of the first half of 2024 but pick up around midyear.

Single-tenant cap rates have continued to trend upward for the eighth consecutive quarter due to higher borrowing costs – a function of both the elevated U.S. 10-year Treasury yield and wider lending spreads over the base rate. As of the first quarter of 2024, trailing 12-month U.S. single-tenant cap rates averaged 6.51%, 16 basis points higher than the prior quarter. However, the rate of cap rate increases appears to be slightly tapering off. The cap rate spread to borrowing costs is tight relative to the past 13 years, but there has been an increase in the number of corporate property owners looking to do sale-leasebacks, even at higher cap rates, since their effective financing costs are lower than alternative forms of financing. Since 2006, single-tenant cap rates have averaged 6.8%, below recent opportunities that are between a 7% and an 8% cap rate.



Aggregate single-tenant investment volume in the first quarter of 2024 was down 67% from the peak recorded in the second quarter of 2022.



Cap rates have continued to trend up from the troughs recorded in 2022.

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Head of TPG AG Net Lease Real Estate

For more information on TPG AG Net Lease Real Estate, click here.

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