

## Maturing Debt Bolsters Mezz-Lending Boom

High-yield lenders say they are having a big year, as subordinate debt and preferred equity have become increasingly crucial to refinancing overleveraged properties and to funding acquisitions.

**Commercial Mortgage Alert's** 14th annual survey of high-yield lenders has identified 190 shops that provide subordinate debt on commercial real estate via mezzanine loans, B-notes and preferred-equity investments. That includes 121 firms that also finance construction projects.

The overall tally has increased by roughly a dozen lenders in each of the last four years, even as some shops have dropped off the list along the way.

Of the 122 survey respondents that provided their 2024 volumes of subordinate debt and their comparable projections for this year, 116 are calling for an increase in their annual lending volume, while just two predict a decline. The remaining four expect it to stay the same.

**JPMorgan Chase** leads the pack, anticipating that its subordinate-debt originations will total \$3 billion this year. **Blackstone** ranks a close second, with a comparable projection of \$2 billion to \$3 billion. The next-highest estimates came from **Kayne Anderson Real Estate** (\$2.5 billion), **Nuveen Real Estate** (\$2 billion) and **Wells Fargo** (\$1.6 billion to \$2 billion).

**Affinius Capital** plans to originate \$1.5 billion by yearend, followed by **Madison Realty Capital** (\$1 billion to \$2 billion) and **Deutsche Bank** (\$1.25 billion). Next up are **CPP Credit Investments** and **Related Cos.**, with targets of \$1.2 billion each, and **BlackRock** (\$1 billion to \$1.25 billion).

Meanwhile, eight other lenders each weighed in with a \$1 billion estimate for 2025: **AustralianSuper**, **Brookfield**, **Fortress Investment**, **GreenBarn Investment**, **Goldman Sachs**, **Mavik Capital Management**, **Rockwood Capital** and **Sculptor Real Estate**.

The overwhelmingly bullish outlook among subordinate lenders stems largely from rampant volatility in the broader financial markets over the last three years or so. Lower commercial real estate values, higher interest rates and other factors have prompted property owners and buyers to look for ways to supplement the lower loan proceeds that senior lenders now are willing to provide.

Many industry pros expressed similar views a year ago, but

their lending activity in the second half of 2024 didn't live up to the hype — primarily due to a slower-than-expected decrease in interest rates. Their current optimism can be chalked up to this year's surge in demand for subordinate financing, amid a huge wave of commercial real estate loans coming due.

It also helps that lenders and servicers have become less willing to extend existing loans any more than they already have — cutting off borrowers' most popular strategy for dealing with maturing debt in recent years.

"There's a significant need for subordinate capital in today's environment," said **Jonathan Roth**, a co-founder and managing partner at **3650 Capital**. "Anyone seeking to finance an asset based on its cashflow is going to have issues around debt-service coverage ratios and debt yields. ... Regardless of the metrics being used, they are likely to come up short."

Subordinate financing can be especially helpful for middle-market borrowers, who often do not have enough cash on hand to cover the difference between what they owe and the potentially reduced proceeds on a new senior loan, Roth said.

"Borrowers are becoming more open to subordinate debt as a way to avoid diluting [or giving up] their equity in a property" via a recapitalization or sale, said **Tom Lorenzini**, a senior vice president at **Tremont Realty Capital**.

The catch is that "you still need to own solid assets in the right markets that just need more time to reach their full potential," he said. "We want to lend in a situation where there is room for value creation."

Still, other lenders noted that an outright sale could be the only viable option for some owners of overleveraged properties — even if it means taking a loss. "When you have mezzanine debt coming in, the math doesn't always work," said industry veteran **Michael Mazzei**, chief executive of **BrightSpire Capital**.

"With base rates this high, the cost of capital behind the new first mortgage will just bury the borrower, and they'll never get their equity out anyway," he said. "The mezzanine lenders' phones should be ice cold right now. The answer is not always to put a 12% mezz loan behind a senior mortgage. If the borrower really believes in the property, the capital stack has to be recalibrated where there is more equity — or the property has to be sold, resetting the valuation." ❖

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