Private markets

Quarterly private markets update

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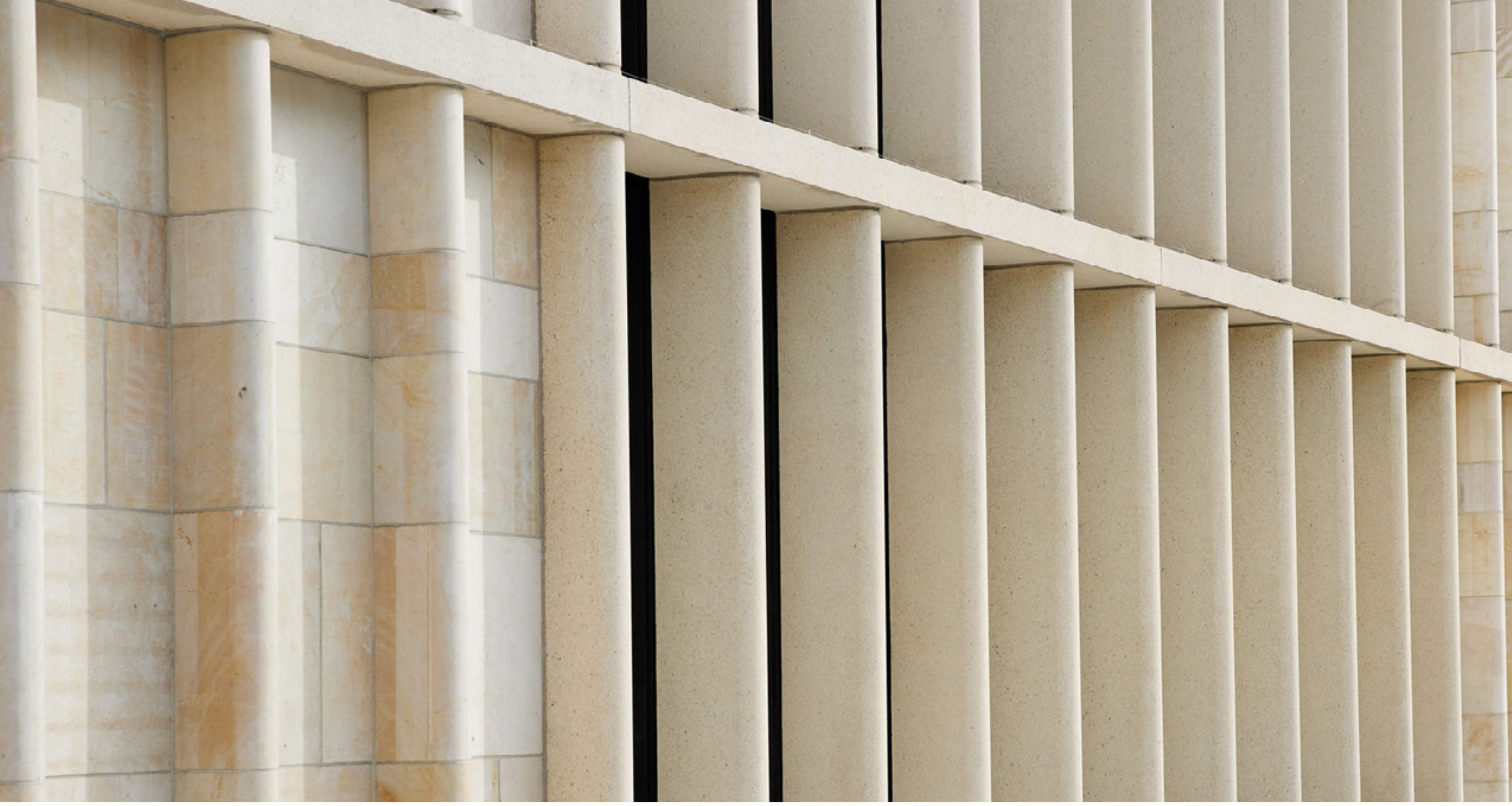


At a glance

- Private assets can play a key role in long-term investment plans, with potential benefits both in terms of better risk-adjusted performance over traditional asset classes and enhanced diversification.
- Over the long run, we expect portfolios that include private assets to outperform those that do not, as less efficient markets and active ownership should offer greater opportunities to capture a premium.
- In private equity (PE), we currently seek exposure to value-oriented buyouts and continue to recommend allocations to secondaries. We anticipate exit options for portfolio companies to improve in 2025 with secondary exit solutions becoming a more favored liquidity option. We expect more Limited Partners (LPs) and General Partners (GPs) to continue to use the secondaries market for liquidity solutions across both PE and venture capital (VC).
- We continue to recommend private credit; however, manager selection is key. Manager dispersion is far greater in private credit than public credit, and manager performance tends to persist across top and bottom private-fund managers. With yields near 10%, low defaults, declining leverage, and ample covenants, alongside CIO's outlook for lower growth combined with two Fed cuts in 2H25, we remain constructive on the sector. With ample dry powder and lower sensitivity to market volatility, we continue to recommend private credit and anticipate outperformance versus its public counterpart.
- In real assets, the case for private real estate as a diversifier remains intact. A bottoming trend in a majority of CRE values began occurring in late 2024, and the results through January 2025 are encouraging. We believe 2025-30 will be rewarding to those investors who do detailed market, submarket, and asset-specific research to identify those markets that are benefitting from strong demographics, migratory patterns, and job creation.

Private equity

Summary

- Performance for US PE for 3Q24 shows steady improvement after a difficult 2023. US PE internal rate of return (IRR) for 3Q24 was 2.5%, while US Venture Capital increased by 1.3% according to Cambridge Associates benchmarks. Looking at longer-term horizons, US PE and US VC continue to demonstrate their value proposition, outperforming relative to public markets on a 10-year relative basis. Over the past 10 years, US PE returned an annualized 15.4% and US VC returned 14.3%, outperforming both the S&P 500 and Russell 2000.

- US PE exit activity recovered substantially in 2024, ending a two-year decline. Through 4Q24, exit value has rebounded by 49% y/y, driven by larger M&A exits. While exit activity has picked up, a substantial inventory of PE-backed companies remains. There is an estimated backlog of eight years' worth of companies waiting to exit.

- Persistent macro uncertainties, particularly around inflation trajectories and monetary policy, are keeping investors cautious. Policy ambiguity regarding potential tariffs and other macro issues further compound this uncertainty. The combination of these factors suggests that while fundamental conditions for PE activity are improving, the pace of recovery may be moderated by broader economic and policy concerns. In this environment, GPs are maintaining their focus on operational improvements and preparing companies for exit opportunities when market conditions stabilize.

- Secondary market pricing continued its upward trajectory in 2024, with average pricing for LP portfolios across all strategies rising to 89% of NAV. This marked the second consecutive year with a 400-basis-point pricing improvement, building on the recovery that began in 2023 after the challenging market conditions of 2022.

- We continue to see opportunities this year in secondaries, driven by multiple fundamental tailwinds, including programmatic utilization of the secondary market by LPs and GPs, robust fundraising momentum, and the continued expansion of the buyer universe. The market's growth reflects its expanded role as a strategic portfolio management tool for both LPs and GPs rather than merely a liquidity solution for distressed sellers or underperforming assets.

- In buyouts, we prefer GPs with a strong track record in value-creation tactics, a particular focus on growing margins and revenues, and an ability to secure lower entry multiples. We see the opportunities in those buyout strategies with a tilt toward value as well as in more complex situations such as carveouts, spin-offs, and divestitures where valuations and the potential for value creation are particularly attractive. Finally, managers are also poised to leverage AI and ML to unlock additional value.

Overview

The US private equity market experienced significant recovery in 2024 compared to 2023, marked by an uptick in deal activity and overall performance. This resurgence was driven by factors such as moderating inflation, enhanced credit availability, and reduced interest rates. Traditional banks re-entered the lending sector, contributing to increased syndicated LBO loan volumes and refinancing activity, creating both credit availability for deals and liquidity within the private equity ecosystem. Private equity performance showed notable progress, with one-year returns reaching 9.2% through 3Q24, compared to 7.2% for the same period in 3Q23, though still trailing the S&P 500.

Fundraising faced headwinds, moderating from recent years but still above pre-pandemic levels. The median time to close extended to 16.8 months from 11 months in 2022, due to limited distributions. Perpetual funds targeting high-net-worth investors have seen robust interest, aiming to tap into the USD 430 trillion private wealth channel.

The outlook for 2025 presents a more complex picture. While the PE industry demonstrates a clear appetite for dealmaking and conditions appear supportive, with lower interest rates and improving sentiment going into end-2024, early 2025 global M&A activity signals continued market hesitation. Persistent macro uncertainties, particularly around inflation trajectories and monetary policy, are keeping investors cautious. Policy ambiguity regarding potential tariffs and other macro issues further compound this uncertainty. The combination of these factors suggests that while fundamental conditions for PE activity are improving, the pace of recovery may be moderated by broader economic and policy concerns. In this environment, GPs are maintaining their focus on operational improvements and preparing companies for exit opportunities when market conditions stabilize.

Given the uncertainty surrounding the macro environment, we continue to see opportunities in the secondaries market and anticipate increased activity driven by fundraising momentum, expanding buyer universe, and the need for distributions driven by LP demand. In the buyout sector, we prefer GPs with strong track records, a focus on growing margins and revenues, securing lower entry multiples, and driving value-creation tactics. Managers are also poised to leverage AI and ML to unlock additional value.

Performance

Performance for US PE for 3Q24 shows steady improvement after a difficult 2023. US PE internal rate of return (IRR) for 3Q24 was 2.5%, while US Venture Capital increased 1.3% according to Cambridge Associates benchmarks. US private equity markets have shown modest performance, with trailing one-year returns below 10% and underperforming public markets. This performance can be linked to various structural and macroeconomic factors:

- Valuation lag effect: The inherent lag in private market valuations means that private performance doesn't immediately reflect public market movements. This lag effect was also seen in 2022 when the S&P 500 was down 16%, and PE was only down 5%.
- Market concentration: A handful of stocks, commonly called the "Magnificent Seven," has been dominating public market performance. This narrow rally has not provided an environment for robust exits or valuation comps for the broader private companies.
- Monetary policy impact: The Federal Reserve's aggressive interest rate hikes since mid-2022 have created a difficult deal-making environment. Increased borrowing costs diminish potential equity returns and reduce buyer appetite. The macro environment has made it difficult for exits, lengthening the holding period for both PE and VC asset classes, which dragged down IRR performance versus their long-time average. The spread between top- and bottom-quartile managers remained wide, underscoring the importance of manager selection. (Please see our latest *Private markets asset allocation guide* for dispersion data.)

While 4Q24 performance data are not yet available, we can look to the US public manager performance as a directional indicator. Across the seven publicly traded PE managers, median gross IRR for 4Q24 was 1.8% and trailing one-year gross IRR was 9.1%, indicating a slow recovery to annualized double-digit returns.

Looking at longer-term horizons, US PE and US VC continue to demonstrate their value proposition, outperforming relative to public markets on a 10-year relative basis. Over the past 10 years, US PE returned an annualized 15.4% and US VC returned 14.3%, outperforming both the S&P 500 and Russell 2000 (Fig. 1).

The cyclical nature of market performance is evident in the quilt chart analysis in Figure 2, demonstrating the importance of vintage diversification. All asset classes have periods of overperformance and underperformance. However, over market cycles, private equity typically stands out with strong, stable returns. Private equity, in dark purple, has been a top performer (in the top or second position) in 11 of 20 years, returning an annualized 14.5% from 2005 to YTD 2024. This consistent performance supports the case of including PE in a diversified portfolio.

Including alternatives in a diversified portfolio can help drive outperformance while experiencing lower reported volatility. A hypothetical diversified portfolio of 40% global equities, 30% US bonds, and 30% alternatives would have returned

Figure 1

Performance by asset class

Asset Class	Q3 2024	Q2 2024	Q1 2024	Q4 2023	1-year	3-year	5-year	10-year
US buyout	2.4%	1.5%	1.8%	3.1%	9.1%	7.4%	16.1%	15.1%
US growth equity	2.8%	1.9%	1.8%	2.7%	9.4%	0.6%	17.4%	16.3%
US private equity	2.5%	1.6%	1.8%	3.0%	9.2%	5.6%	16.4%	15.4%
S&P 500	5.9%	4.3%	10.6%	11.7%	36.3%	11.9%	16.0%	13.4%
US venture capital	1.3%	–1.1%	2.5%	0.5%	3.3%	–5.5%	15.1%	14.3%
Russell 2000	9.3%	–3.3%	5.2%	14.0%	26.8%	1.8%	9.4%	8.8%
Private credit	2.7%	2.6%	3.0%	3.0%	11.7%	9.8%	9.4%	8.9%
Morningstar LTSA US LL	2.0%	1.9%	2.5%	2.9%	9.6%	6.5%	5.7%	4.9%
US real estate	0.2%	–0.1%	0.2%	–2.2%	–1.9%	2.9%	6.5%	8.9%
NCREIF	0.8%	–0.3%	–1.0%	–3.0%	–3.5%	0.9%	3.3%	5.9%

Source: Bloomberg, Cambridge Associates, UBS, as of 30 September 2024

Figure 2

Quilt chart – total returns

Highest return

2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024 (YTD)	2005 - 2024 YTD return (ann.)	2005 - 2024 YTD return std dev (ann.)
32.0%	33.8%	19.3%	5.2%	58.1%	23.0%	10.7%	16.8%	32.4%	13.8%	10.3%	17.5%	27.2%	12.3%	31.5%	29.1%	41.8%	8.4%	26.3%	22.1%	14.5%	9.4%
26.4%	32.2%	18.3%	-6.5%	41.4%	15.8%	9.7%	16.0%	23.5%	13.7%	10.3%	12.3%	21.8%	8.4%	21.5%	18.4%	28.7%	6.3%	15.6%	14.2%	10.4%	16.0%
16.6%	27.7%	17.1%	-13.0%	26.5%	15.1%	9.2%	15.5%	15.3%	13.4%	6.9%	12.0%	20.5%	8.1%	**19.3%**	**15.4%**	25.4%	2.9%	**15.3%**	**12.9%**	9.5%	3.4%
11.5%	26.7%	16.7%	-19.0%	**23.3%**	15.1%	7.8%	14.6%	14.8%	9.6%	5.5%	11.2%	19.1%	7.3%	18.5%	**14.3%**	**15.7%**	-4.1%	13.5%	**10.4%**	9.0%	8.0%
10.1%	**17.2%**	**11.7%**	**-23.1%**	20.0%	15.1%	4.4%	14.0%	**13.8%**	**7.1%**	**2.0%**	9.1%	**15.5%**	0.0%	**17.5%**	11.8%	14.4%	-4.2%	**12.9%**	8.5%	**8.0%**	**8.8%**
9.3%	15.8%	10.2%	-24.6%	**18.0%**	**13.3%**	4.3%	**11.9%**	12.7%	6.0%	1.4%	**7.3%**	**15.4%**	**-0.7%**	14.4%	11.4%	12.8%	-11.2%	12.1%	8.2%	7.2%	9.8%
7.7%	**14.2%**	10.0%	**-25.3%**	14.5%	11.2%	**2.6%**	**11.5%**	**12.4%**	5.8%	0.6%	6.9%	14.6%	-2.3%	10.4%	10.7%	**10.2%**	**-11.2%**	9.3%	8.0%	6.4%	10.5%
7.5%	13.7%	**9.9%**	-26.1%	13.2%	**10.8%**	2.1%	10.1%	9.7%	**4.9%**	**-1.0%**	**5.8%**	8.6%	-4.4%	9.3%	7.5%	10.2%	-13.0%	8.5%	6.0%	**6.3%**	**10.5%**
4.9%	12.9%	7.0%	-32.7%	5.9%	10.2%	**-0.9%**	9.9%	9.1%	3.0%	-1.1%	5.4%	8.6%	-4.7%	9.1%	6.1%	7.8%	-16.0%	8.1%	4.4%	5.5%	18.5%
2.8%	10.8%	5.5%	-37.0%	1.1%	10.2%	-5.3%	6.4%	7.4%	2.5%	-4.6%	4.5%	7.5%	**-5.5%**	9.0%	5.5%	5.3%	**-16.1%**	5.5%	3.2%	5.2%	7.6%
2.4%	4.3%	2.5%	-45.5%	-22.9%	6.5%	-13.7%	4.2%	-2.0%	-3.9%	-5.7%	2.6%	3.5%	-14.2%	8.7%	1.8%	-1.5%	-18.1%	-4.1%	-0.1%	3.2%	4.4%

Lowest return

Key

US large-cap equities	International equities	US bonds	US high yield bonds	Hedge funds	**60% global equities / 40% US bonds**
Global private infrastructure	US private equity	US private debt	Global private real estate	**40% global equities / 30% US bonds / 30% privates**	

Alternatives allocation: 17% PE, 7% private debt, 4% private real estate, and 2% private infrastructure.
Note: For illustration purposes. Past performance is no indication of future returns.
Source: Bloomberg, Cambridge Associates, UBS, as of 30 September 2024

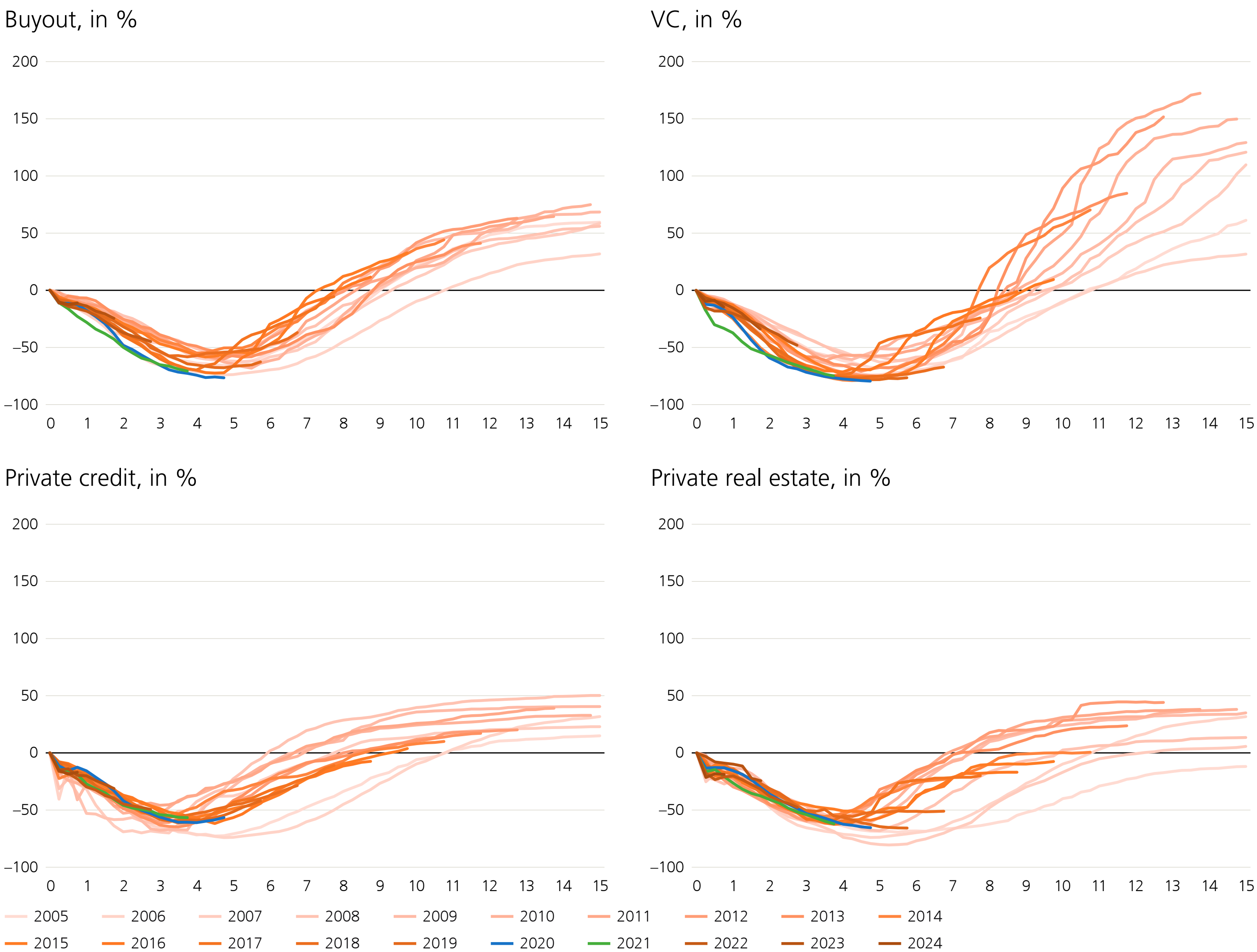
an annualized 8.0%, with 8.8% reported volatility. By comparison, a traditional 60% global equities and 40% bonds would have generated a 6.3% return with 10.5% reported volatility.

Net cash flow

When examining net cash flows, many investors are acquainted with the J-curve effect of drawdown funds, which is characterized by initial negative returns (drawdown) followed by positive returns as investments mature (distributions). While cash flows have traditionally adhered to this pattern, recent slowdowns in distributions have altered the conventional J-curve effect. This change is more pronounced in certain asset classes than others. Specifically, cash flows for recent vintages in buyout and venture capital have become steeper, most notably for 2020 and 2021 vintages for buyout and 2018-2021 vintages for VC. Younger vintages in the private real estate J-curve have shown flattening, indicating a longer time to net cash flow breakeven, while private credit has largely been unchanged due to its self-liquidating nature and floating rate structure. Unlike private equity, private credit instruments typically generate regular interest payments and return principal at maturity, creating natural distribution events independent of market conditions.

Figure 3

Cumulative net cash flow as a percentage of total commitment



Source: MSCI, UBS, as of 9 September 2024

Deal activity

US PE deal activity has seen a recovery in 2024 compared to 2023, with deal activity increasing approximately 19% y/y by deal value and 13% on deal count, according to PitchBook data. YTD through 4Q24 PE deal activity totaled USD 838bn of deal value (Fig. 4) driven by more favorable market conditions, including lower interest rates and tighter credit spreads that helped reduce financing costs and narrowed the buy-sell valuation expectations.

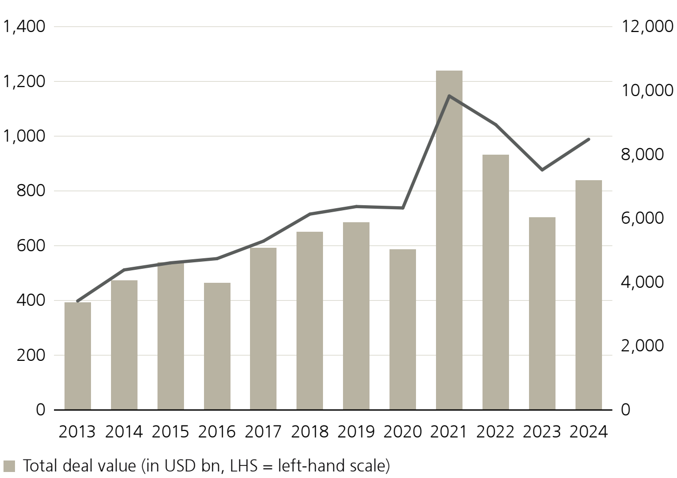
The technology sector, particularly in software, emerged as the standout performer, reflecting PE managers' continued focus on high-quality assets offering strong cash flow, high-margin businesses with strong growth trajectories.

Fundraising

Despite the challenging macro environment and slower pace of distributions, LPs continue to demonstrate confidence in the asset class's long-term prospects and have remained committed to allocating to PE. Private equity fundraising will likely end the year with around USD 300bn raised, down from 2022's peak of around USD 400bn. Though the data do not include those raised from perpetual, open-ended vehicles, we estimate another USD 50bn has been raised since 2019 based off Pitchbook data. Geared toward the individual private wealth investor, the open-ended fund structure is growing in popularity owing to its immediate capital deployment, lower minimums, limited period liquidity, and simplified tax reporting, with fewer operational burdens (i.e., lack of capital calls and distributions) than traditional closed-ended drawdown funds with comparable exposures. Please see our research publication, *Accessing private equity with perpetual capital funds*, for additional insights.

Figure 4

US PE deal volume (USD in billions)

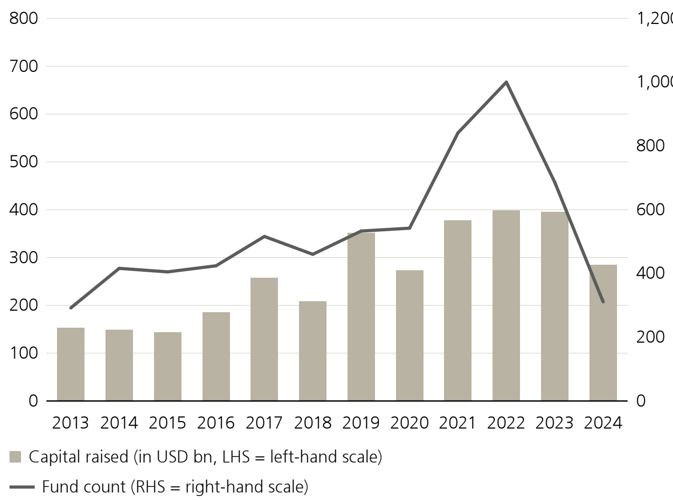


Source: Pitchbook, as of 31 December 2024

Established managers continue to dominate the landscape, while newer or smaller ones struggled. Mega funds, funds that raise over USD 5bn, accounted for 44% of dollars raised through 4Q24. Middle-market funds, those that raise between USD 100mn and USD 5bn, have maintained strong interest, raising an aggregate value of USD 158bn across 172 funds, representing 55% of all capital raised in 2024. These funds have benefitted from the more challenging macroeconomic landscape as investors gravitate toward smaller funds focused on smaller deals where financing is more accessible, and valuations tend to be more favorable.

Figure 5

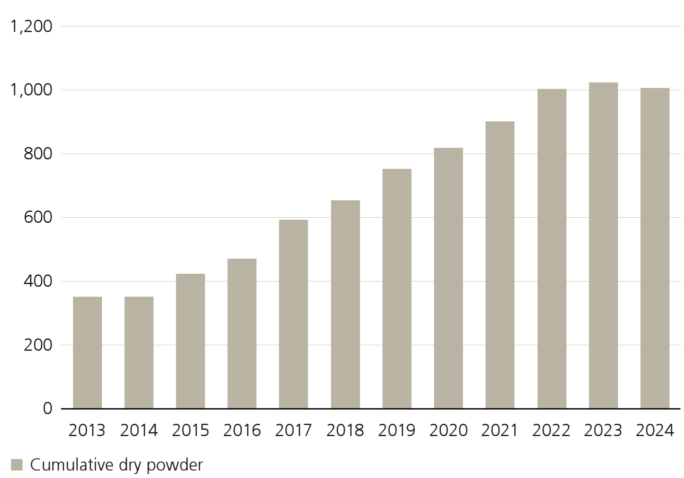
Historical US PE fundraising (USD in billions)



Source: Pitchbook, UBS, as of 31 December 2024

Figure 6

US private equity dry powder (USD in billions)



Source: Pitchbook, UBS, as of 30 June 2024

Valuations

Full year 2024 US PE valuations appear to be on an upward trend once more, following a minor decline in 2023. While public markets rallied to highs in comparison, PE entry multiples have shown more stability (Fig. 7). According to Pitchbook LCD, LBO entry multiples ex-fees for deals done through 4Q24 averaged 10.6x, improving from the average LBO entry multiple of 10.4x for full year 2023, though still below the peak of 11.5x for full year 2022. Compared to public equities which are trading at historically high multiples, private valuations have been more stable in their recovery and offer attractive entry points to deploy capital. We expect valuations to remain below the record highs seen in recent years, as investors adjust to a higher interest rate environment and place greater emphasis on fundamental value creation.

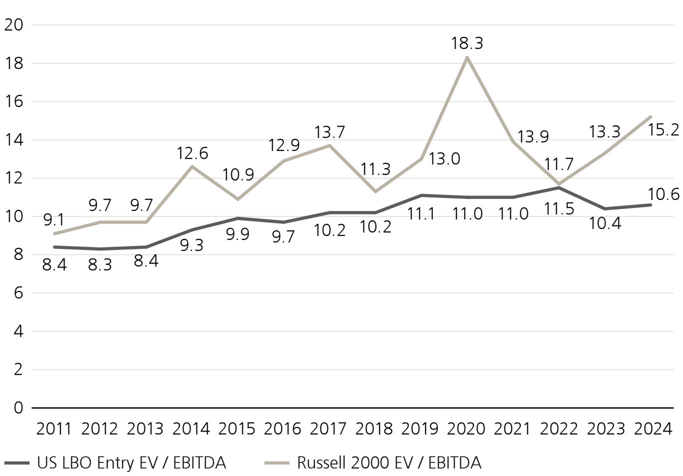
Exits

Exits are a critical mechanism in the private equity ecosystem, serving as the primary means by which PE managers realize returns for their investors, who then fuel new fundraises that enable investments into new companies. US PE exit activity achieved a substantial recovery in 2024, ending a two-year decline. Through 4Q24, exit value has rebounded 49% y/y, driven by larger M&A exits.

Corporate acquisitions continue to remain the dominant exit landscape, accounting for 55% of exit value in 2024. This trend highlights the persistent appetite for strategic M&A among corporate buyers as well as the relative scarcity of other exit options in the current market. Managers have been able to leverage their operational expertise and industry insights to position their portfolio companies as attractive acquisition targets for strategic buyers.

Figure 7

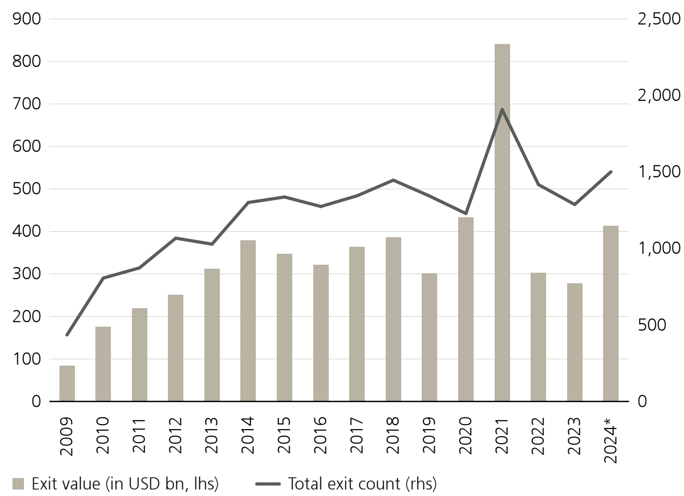
Private market multiples vs. public market multiples



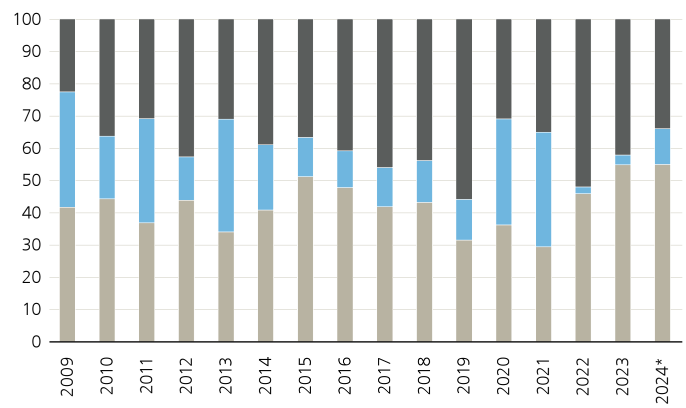
Note: ex-fees
Source: Bloomberg, Pitchbook LCD, UBS, as of 31 December 2024

Figure 8

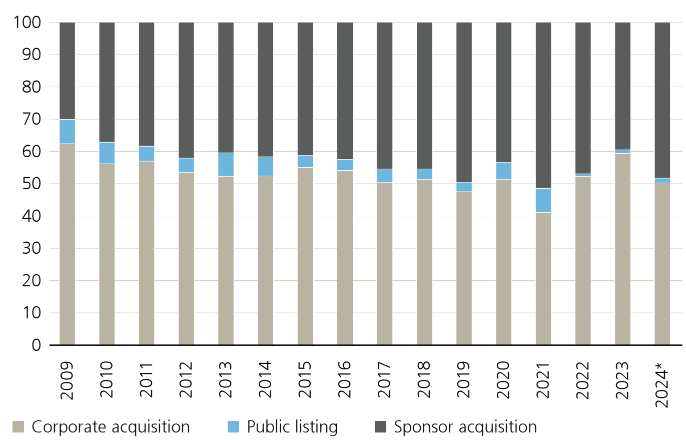
US PE Exits



US PE exit value (USD in billions) by type, in %



US PE exit count by type, in %



*As of 31 December 2024
Source: Pitchbook, UBS, as of 31 December 2024

The IPO activity market showed signs of recovery with 16 PE-backed companies successfully completing public listing through 4Q24 compared with 14 exits in 2023. Stronger public market and enhanced macroeconomic stability at year-end 2024 suggested improving confidence in public markets.

While exit activity has picked up, a substantial inventory of PE-backed companies remains. There is an estimated backlog of eight years' worth of companies waiting to exit, assuming exiting at the current rate of ~1,500 companies per year. The pressure on holding periods is high, with the median hold time of about 7.0 years, up from the 5.4-year average. With the bulk of companies coming from 2017-2019 vintages, the mounting pressure has led to increased interest in other exit routes, including continuation funds and secondaries.

Secondaries

The secondary market demonstrated exceptional strength throughout 2024, achieving a new annual record with USD 162bn in transaction volume, a 45% increase from 2023 and 23% above the previous peak of USD 132bn in 2021. This volume was driven by improving pricing conditions, sustained liquidity demands from institutional investors, broader adoption of general partner-led transactions, and an influx of capital from both traditional and emerging sources. The secondaries market demonstrated significant momentum throughout the year, with the second half of the year's transaction volume totaling USD 94bn, outpacing the first half of USD 68bn. We anticipate the momentum to continue into 2025, with record levels of dry powder and expectations of continued growth across both limited-partner-led and general-partner-led segments.

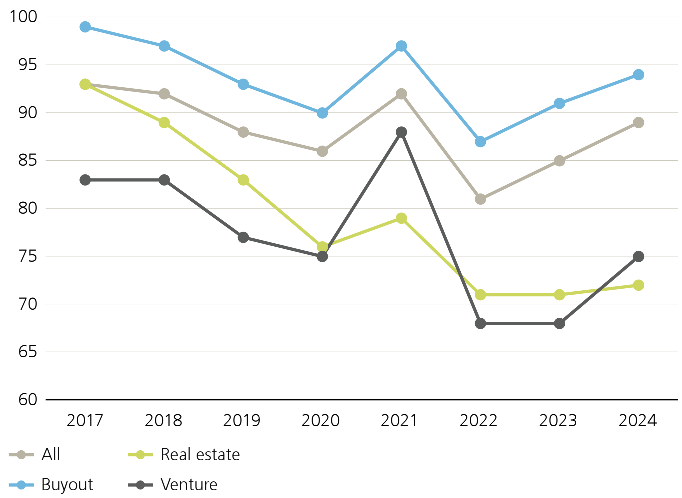
Pricing trends

Secondary market pricing continued its upward trajectory in 2024, with average pricing for LP portfolios across all strategies rising to 89% of NAV (Fig. 9). This marked the second consecutive year with a 400-basis-point pricing improvement, building on the recovery that began in 2023 after the challenging market conditions of 2022.

Pricing improvements were observed across most asset classes, but the degrees vary across the different strategies, reflecting the differentiated risk-return profiles and investor preferences. Buyout funds achieved the highest pricing at 94% of NAV, a 300-basis-point increase from 2023. Venture funds experienced a substantial recovery, rising 700 basis points to 75% of NAV. And real estate funds remained relatively stable at 72% of NAV.

Figure 9

Secondary market portfolio pricing as a percentage of NAV



Source: Jefferies, UBS, as of 31 December 2024

The pricing recovery was supported by several factors, including:

- Rising public markets (with the S&P 500 increasing approximately 23% in 2024)
- The Federal Reserve interest rate cuts (100bps in total)
- Improved investor confidence in near-term exits
- Strong fundamental performance of portfolio companies
- Increased competition among buyers, particularly for high-quality assets

Pricing also demonstrated meaningful variance based on fund vintage, with newer vintages commanding substantial premiums. Buyout funds with vintages 2021 and newer priced at 99% of NAV, while those with vintages between 2018 and 2020 priced at 96% of NAV. Funds older than 10 years experienced notable pricing recovery, reaching 72% of NAV on average, an improvement that reflects enhanced buyer confidence in near-year distribution.

Geographically, transactions were concentrated in North America, representing 80% of transaction volume, Europe (15%), and Asia, which continued to present a small portion of the market at 4% of total transaction volume.

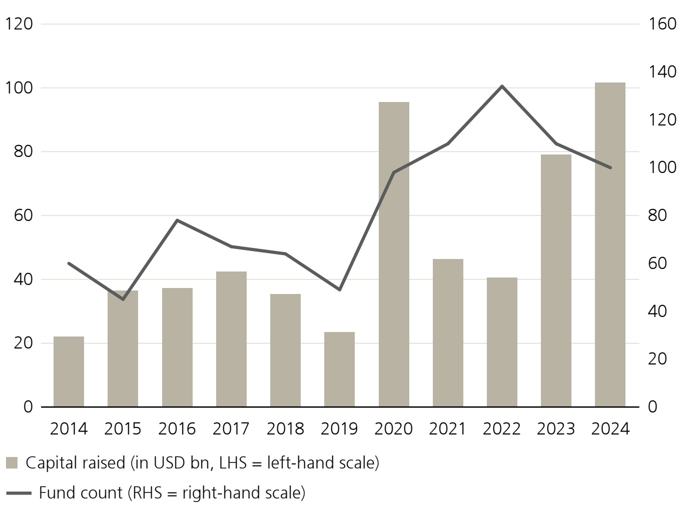
Transaction structures continued to evolve in 2024, with participants increasingly employing sophisticated approaches to close deals. Alternative structures, including preferred equity arrangements, managed funds, and special purpose vehicle portfolio transfers, represented approximately 7% of total volume. These structures enabled sellers to preserve upside potential while securing immediate liquidity. Deferred pricing mechanisms, where a portion of purchase price is received in the future in exchange for higher transaction price, were used in approximately 20% of LP transactions. These arrangements increase average pricing by about 400bps compared to the conventional all-cash transactions, highlighting the market's increasing flexibility in structuring mutually beneficial transactions.

Capital availability

Secondaries fundraising in 2024 surpassed the previous high established in 2020. This robust fundraising activity against a backdrop of challenging capital raising in other private market segments demonstrates the appeal of secondary strategies. Current estimates place global available capital for secondaries at around USD 200-300bn, which includes leverage and evergreen vehicles. Despite the available capital, the capital overhang multiple, which is the available capital divided by annual transaction volume, is at 1.8x through end-2024, down from 2.3x in 2023. This reduction indicates that capital deployment accelerated more rapidly.

Figure 10

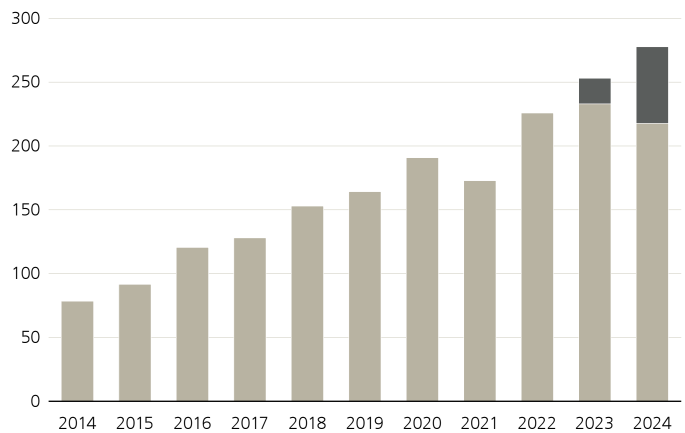
Historical global secondaries fundraising



Source: Pitchbook, UBS, as of 31 December 2024

Figure 11

Global secondaries dry powder (USD in billions)



Note: dark bar represent estimated open-ended capital
Source: Pitchbook, UBS, as of 31 December 2024

We continue to see opportunities in secondaries for 2025, driven by multiple fundamental tailwinds including programmatic utilization of the secondary market by both LPs and GPs, robust fundraising momentum, and the continued expansion of the buyer universe. The market's growth reflects its expanded role as a strategic portfolio management tool for both LPs and GPs rather than merely a liquidity solution for distressed sellers or underperforming assets. While macroeconomic uncertainties and geopolitical development may introduce volatility, the secondary market's demonstrated resilience and growing importance within the private capital landscape suggest that its long-term growth trajectory remains intact.

Venture capital

Summary

- The US venture capital fundraising environment remained challenged throughout 2024, with total capital commitments reaching approximately USD 74bn, representing the lowest annual fundraising volume since 2019. Despite the slowdown in fundraising, dry powder in US VC remains substantial at approximately USD 300bn.

- AI-focused funds have seen strong LP interest; however, even within AI, there are signs of increasing investor selectivity. With the high valuations and concentration of capital in the sector, investors are showing greater discipline in due diligence and increasingly focusing on companies with clear paths to commercialization and sustainable business models.

- AI and ML investments accounted for 46% of total venture deal value in 2024. This share represents a substantial increase from the average 24% share during 2019-22.

- The secondary market continues to be a bright spot, with median discounts narrowing from their high of 30%, indicating improving investor confidence. In the current environment, we believe investors looking for venture exposure could find opportunity in venture secondaries to gain exposure to a diversified portfolio at attractive discounts.

Overview

The US venture capital market navigated challenges in 2024, particularly in fundraising and exits. While valuations appeared resilient, this masked underlying stress. Down and flat rounds reached ~25% of deals, and one-year performance returned a dismal 3.3% through 3Q24. AI and ML emerged as the defining sector of 2024, capturing 46% of total deal value, up significantly from just 24% average during 2019-22. While AI-focused companies may continue to command premium valuations, the broader market faces an extended period of readjustment.

The exit landscape remained challenging, with M&A activity reaching decade lows. In response to limited traditional exit opportunities, secondary markets gained importance as a liquidity mechanism. Several major VC companies including Databricks, Stripe, OpenAI, and SpaceX raised billions for employee and early investor buybacks.

The venture market is still finding a new equilibrium. However, a meaningful recovery will likely require sustained improvement in exit conditions and continued monetary easing to unlock the value currently held in a record number of companies. The combination of significant dry powder, potential monetary easing, and a maturing company inventory could create the potential for renewed momentum in 2025. In the current environment, we believe investors looking for venture exposure might find opportunity in venture secondaries, which have seen discounts narrow but still trade at attractive levels relative to NAV. The current environment offers access to established portfolios at meaningful discounts. LP portfolio pricing in venture secondaries increased from 68% of NAV 2023 to 75% of NAV in 2024 (Fig. 9) indicating growing buyer interest. Additionally, select primary investments in sectors demonstrating fundamental strength, particularly in AI and other resilient sectors may offer pockets of opportunity.

Fundraising

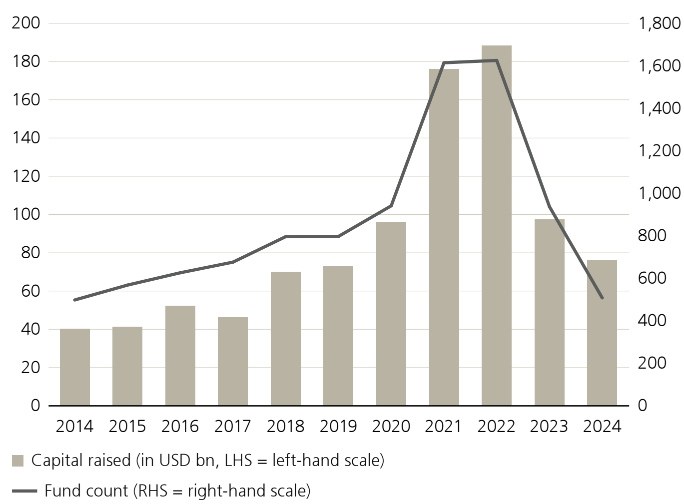
The US venture capital fundraising environment remained challenged throughout 2024, with total capital commitments reaching approximately USD 74bn, representing the lowest annual fundraising volume since 2019. This significant deceleration from the peak years of 2021-22 was driven by persistent liquidity constraints among LPs, stemming from an extended drought of exits, elevated interest rates, and underperforming fund returns.

Despite the slowdown in fundraising, dry powder in US VC remains substantial at approximately USD 300bn. However, this capital is heavily concentrated in 2020-22 funds and in larger sized funds of USD 500mn or more.

The artificial intelligence sector stands as a notable exception to the broader fundraising deceleration. Several prominent venture firms with AI-focused investment successfully raised funds exceeding USD 1.5bn in 2024. According to an IDC study presenting a five-year forecast for the core IT spending for GenAI market, total spend could reach USD 151.1bn in 2027, underscoring the substantial growth trajectory in this segment. Investment pace in AI startups globally accelerated throughout 2024, with AI and ML deal activity totaling USD 97bn for full-year 2024, up from USD 58bn in 2023.

Figure 12

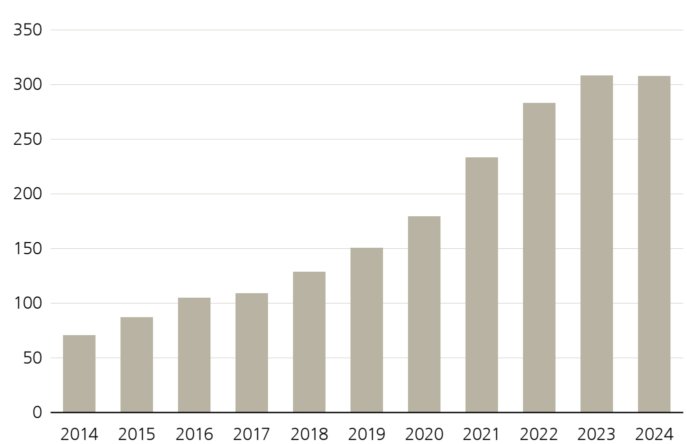
Historical US venture capital fundraising



Source: Pitchbook, UBS, as of 31 December 2024

Figure 13

US venture capital dry powder (USD in billions)



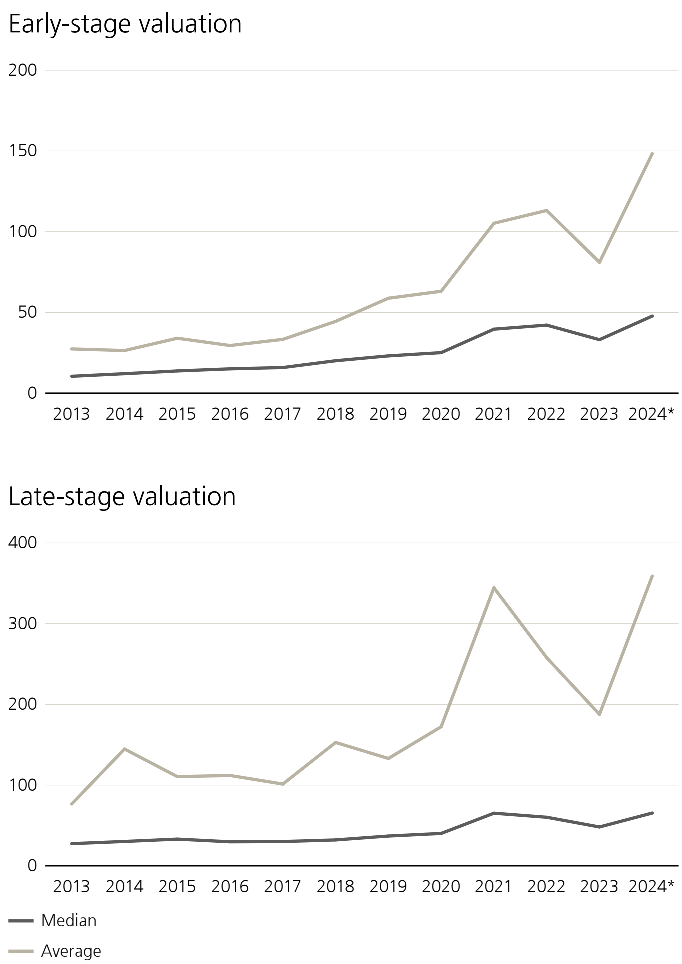
Source: Pitchbook, UBS, as of 30 June 2024

Valuation

Despite the challenging market conditions, venture capital valuation data demonstrated resilience across both early- and late-stage valuations through 4Q24. Median pre-money valuations for early-stage increased approximately 44% y/y, while late-stage valuations rose approximately 36% compared to 2023 levels. While encouraging, the data reflect a growing market bifurcation between high-quality firms, demonstrating that the relative quality of companies can still command strong valuations, even in a more selective funding environment. Further, investors' appetite on certain sectors, such as AI, may have contributed to the overall increase in early-stage valuations.

Figure 14

US venture capital pre-money valuations (in USD millions)



*As of 31 December 2024
Source: PitchBook, UBS, as of 31 December 2024

AI and ML

The artificial intelligence and machine learning (AI and ML) sector continues to dominate the venture capital landscape through 4Q24, demonstrating the resilience among broader market constraints. AI and ML investments accounted for 46% of total venture deal value in 2024. This share represents a substantial increase from the average 24% share during 2019-22.

Total AI and ML deal activity reached USD 97bn through 2024, an increase from USD 53bn in 2023. The surge reflects the significant capital required for AI infrastructure and development, computer resources, and specialized talent acquisition. Median pre-money valuations for AI and ML companies for 2024 was USD 33mn and average pre-money valuations reached USD 554mn, driven by several high-profile late-stage financings (Fig. 15).

The market has witnessed increased bifurcation between a handful of well-funded AI leaders and the broader ecosystem. The five largest AI and ML deals completed in 4Q24 accounted for 43% of the quarter's total deal value, highlighting the extent of capital concentration. These outsized investments have primarily targeted companies developing foundational models and AI infrastructure.

Investment activity continues to see shifting toward earlier-stage opportunities, with companies led by AI researchers gaining market share from established generative AI unicorns. This trend indicates investors' pivot toward specialized applications following the initial waves of general-purpose AI investment.

The path to profitability remains extended for most AI ventures, with median time to positive EBITDA estimated at 5.7 years from founding. However, companies employing AI to enhance existing business processes rather than building novel applications have shown faster paths to profitability, with median breakeven timelines of 3.8 years, according to Pitchbook.

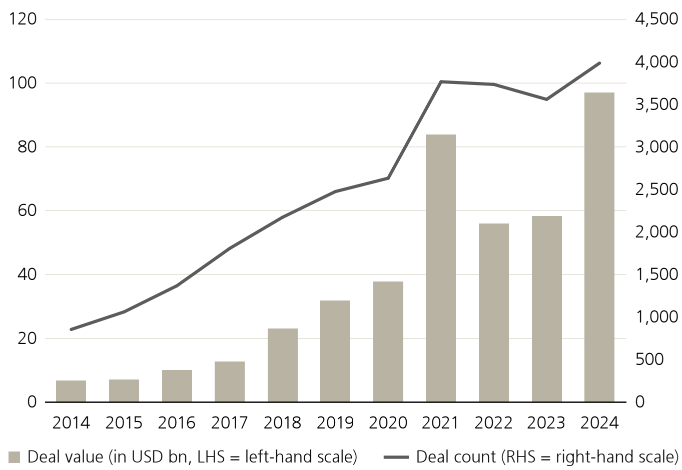
Regulatory developments represent both challenges and opportunities. The new Federal Trade Commission leadership is likely to adopt a more permissive stance toward technology mergers, potentially facilitating exit opportunities for AI startups. At the same time, the future regulatory framework for AI applications in sensitive sectors may create competitive advantages for companies demonstrating robust governance practices.

While AI and ML valuations are rising and the sector is attracting large levels of investment, it is crucial for investors to maintain a balanced perspective. The high valuation and concentration of capital brings increased risks, raising questions of sustainability of the valuation levels and potential for correction, especially if the broader economic environment deteriorates. Furthermore, the high capital requirements for AI infrastructure highlight the competition and potential barriers to entry in this space. As the market evolves, it will be important to watch how these valuations translate into sustainable business models and returns for investors.

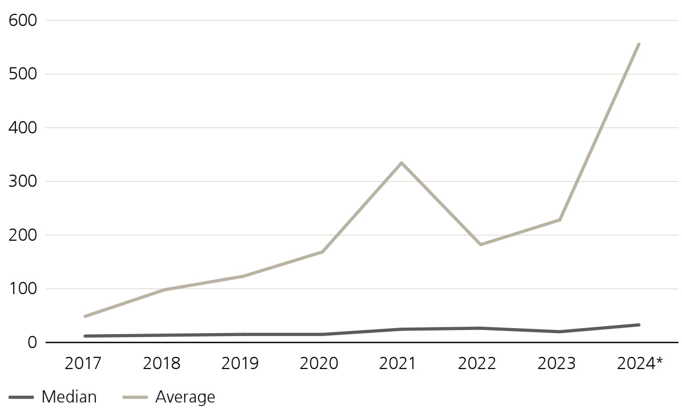
Figure 15

Artificial intelligence and machine learning sector

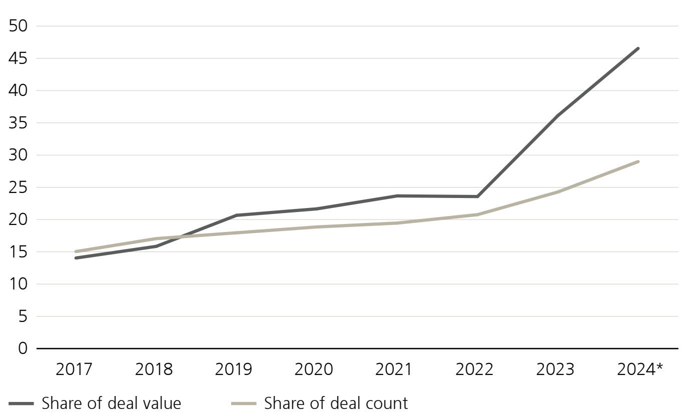
US AI & ML activity



AI and ML valuation (in USD millions)



AI and ML deal activity as a share of all US VC deals (in USD millions), in %



*As of 31 December 2024
Source: PitchBook, UBS, as of 31 December 2024

Private credit

Summary

- The uncertainty of the current market environment is where a diversified portfolio, including allocation to alternatives, may enhance total return and lower overall volatility. Carry within private credit remains ample, defaults remain low, and dry powder abundant.
- As we begin 2025, the anticipated surge in M&A activity has so far been slower to materialize. Still, private credit lenders have been busy, shifting their focus to fundraising and adding to their already robust USD 250bn of dry powder.
- While the end of 2024 saw spreads compress for both public and private markets, there remains an ample pickup in spreads in direct lending, even accounting for the increased competition from banks returning to the marketplace.
- We see the global private wealth market as an area of growth for private credit in the months ahead, with expectations for private wealth allocation to private credit growing by USD 3-4tr in the longer term.
- Use of PIK securities has been rising over the past several years, but defaults have remained stable. While we monitor shifting PIK activity, we do not currently view the overall rise as a point of concern given our expectation of lower interest rates and a lower growth outlook.
- We continue to recommend private credit, with a preference for those managers with disciplined underwriting approaches, diversified business, sophisticated infrastructure, and a proven track record.

Market overview: Volatility and growth outlook

Uncertainty fuels volatility. Equity volatility (as measured by the VIX) has risen by nearly 90% since early February, while the S&P 500 is down about 9%. Policy developments over the past few weeks have triggered a sharp reversal in consumer sentiment, and small business optimism is moderating amid higher economic uncertainty. CEO confidence, though elevated relative to 2023, has softened due to concerns about tariffs, immigration policy, inflation, and interest rates. These factors have also spilled over into lower M&A expectations for 2025. Because strategic M&A activity historically correlates with CEO confidence, this heightened uncertainty—combined with declining consumer sentiment—could continue to weigh on M&A activity in the months ahead (Fig. 1).

The market is now pricing in over 80bps of rate cuts this year, as 1Q25 GDP is poised to decelerate. However, we do not believe a recession is a likely scenario and currently view the market's expectation for the path of the Federal Reserve (Fed) funds rate to be a bit too aggressive. We look for two cuts in 2H25 and maintain the high-for-longer scenario, benefitting floating rate products, until the data show us otherwise.

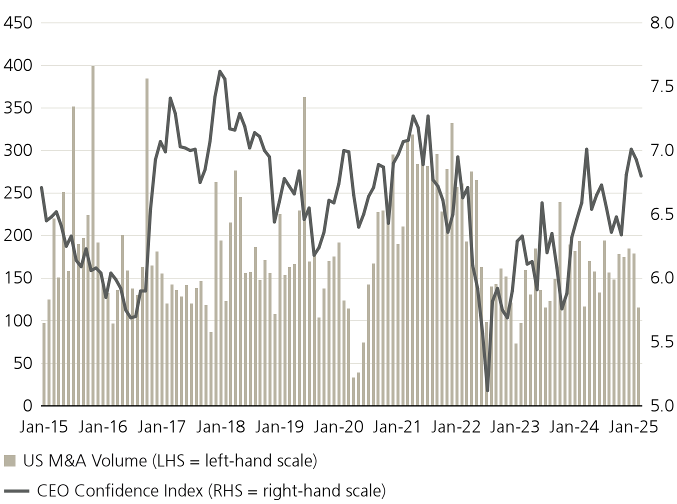
The unwind of risk within the equity market has been abrupt, nearly doubling equity volatility. These are the environments where a diversified portfolio including allocation to alternatives may enhance total return and lower overall volatility. Credit has been resilient given the recent volatility. While spreads are wider, they have remained well-contained, and the risk repricing is much lower than what the market witnessed during the yen carry unwind last summer. Carry within private credit remains ample, defaults remain low, and dry powder abundant. However, alongside the tiering among US consumers, the tale of two economies is prevalent within private credit. One of the most salient features of the past few quarters has been a sharper rise in financial distress among small firms relative to larger ones. This bifurcation reflects the weaker pricing power of small firms, their lack of operational agility, and business mix diversity. We continue to recommend private credit, with a preference for those managers with disciplined underwriting approaches, diversified business, sophisticated infrastructure, and a proven track record. Direct lending raised the most capital within private debt in 2024, and we believe this has continued into 2025 (Fig. 2).

Private credit fundraising and issuance

Despite slower fundraising in 2024, the private credit market continues to grow. Overall, fundraising decreased in 2024 from the previous year and finished about 5% lower than its recent 2021 peak. However, this follows a strong four-year period and came amid several economically volatile months during which the market assessed the Fed's rate path and navigated uncertainty surrounding the 2024 presidential election.

Figure 1

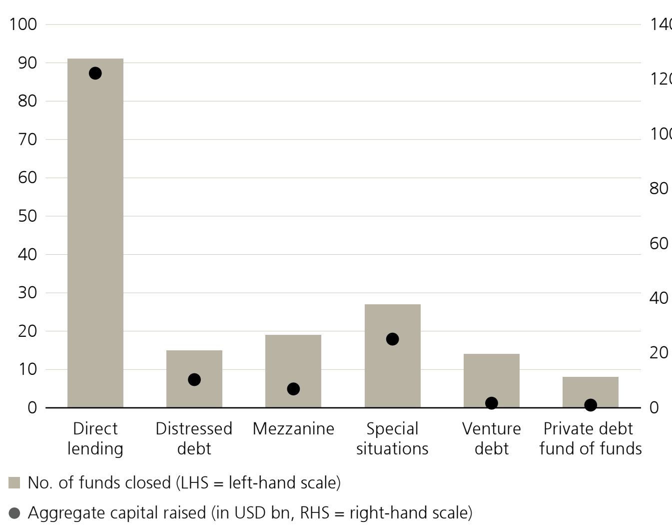
The decline in CEO confidence impacts M&A volume



Source: Bloomberg, UBS, as of 28 February 2025

Figure 2

Full year figures show direct lending with the largest share of fundraising



Source: Preqin Pro

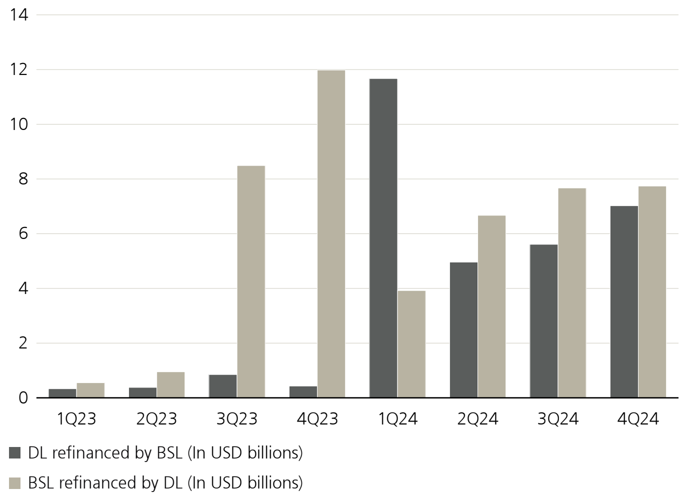
Despite these headwinds, the direct lending market in the US has grown into a USD 1.7tr sector, including around USD 250bn of undeployed "dry powder" (Fig. 3). As the tug-of-war continues between direct lending and broadly syndicated loans (BSLs), private credit financed a record USD 84bn of USD 1bn-plus transactions in 2024—even while BSL markets reopened early in the year and offered tighter spreads to borrowers. In the funding markets, while the question as to whether there is room for both PC and BSL financing lingers, both have reached an equilibrium and many market participants still see this period as a "golden age" for private credit (Fig. 4).

As we begin 2025, private credit managers have focused on fundraising as the anticipated surge in M&A activity has so far been slower to materialize. Short-term headwinds persist due to ongoing economic policy uncertainty, dampening new issuance. But private credit lenders have been busy, with the top ten lenders accounting for 32% of all capital raised so far this year, according to PitchBook. Adding to the existing USD 250bn of dry powder, these inflows could position direct lenders favorably once M&A deals pick up, hopefully later in the year.

Refinancings remain the biggest slice of private credit deals at 20% of the overall market, their highest share since 2020 (Fig. 5). Much of this activity addressed approaching maturity walls, with nearly 80% of borrowers paying loans due between 2024 and 2026. While this refinancing trend has persisted, the market is nonetheless optimistic that M&A will drive activity in

Figure 4

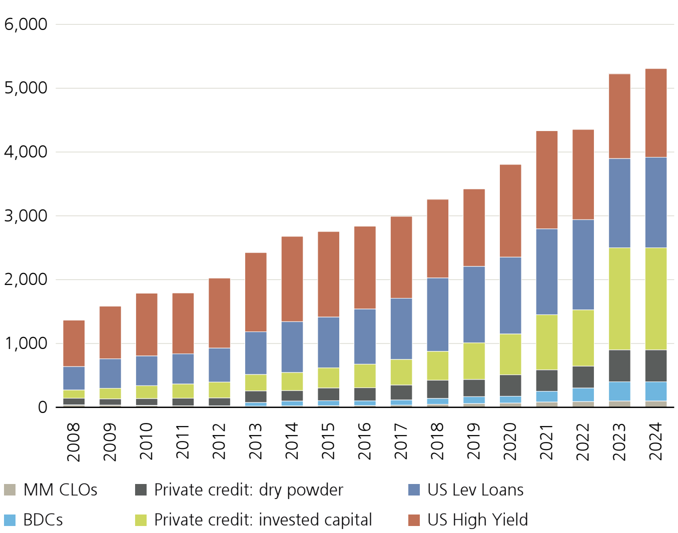
Borrowers are turning equally to direct lending and BSLs for financing



Source: PitchBook, UBS, as of 31 December 2024

Figure 3

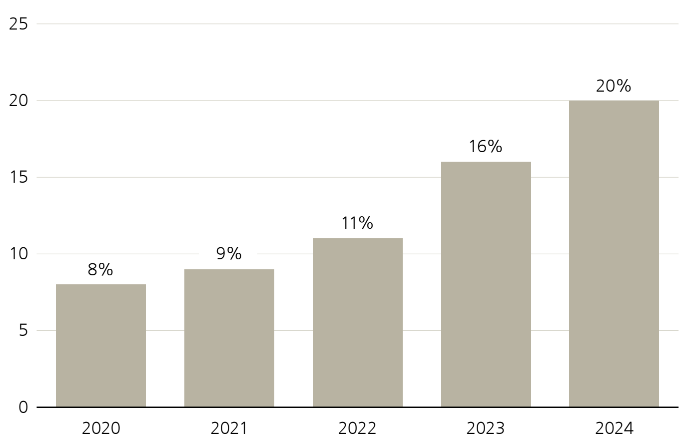
Private credit raised USD 500 million in 2024 and accounts for 32% of capital raised so far in 2025



Source: Pitchbook, UBS

Figure 5

Refinancings remain the driver of direct lending activity, as M&A activity is muted



Source: PitchBook, UBS, as of 31 December 2024

2025, with some already reporting a robust pipeline of leveraged buyout (LBO) deals. Ample dry powder and the recent launch of private credit ETFs by firms such as Virtus, Apollo, and State Street suggest the sector is likely to continue growing steadily throughout 2025.

We expect private credit to see further expansion, especially once economic policy clarifies. Products aimed at retail investors, increased wealth management allocations, and a notable level of dry powder could combine to create a perfect storm of greater investment into private credit.

Performance

Since 2007, private credit has grown to a USD 1.7tr market. During this expansion, the market has witnessed cycles of recessions, pandemics, zero interest rates, low to high access to credit from banks, robust to weak M&A activity, alongside an unexpected period of economic resilience fueling a spike in interest rates. Private credit has continued to grow during these cycles, a testament to not only its durability but also to investors understanding that while not as liquid as their public counterparts in either BSL or equity markets, it is not subject to the day-to-day volatility of the marketplace. And nowhere has this been more prevalent than over the past 1.5 months, as rising uncertainty regarding the amount and length of potential tariff policies has dominated headlines.

The narrative in the marketplace has shifted over the past two months. While robust growth and a robust M&A market led the commentary in the beginning of the year, continued uncertainty and potentially longer tariffs raise concerns over recession or potential stagflation fears. We expect the economy to continue to grow, albeit at a slower pace, as consumers, while more selective, remain healthy.

The environment remains positive for both borrowers and lenders, but the yield earned in 2023 and late 2024 is trending lower in both public and private markets. While volatility has recently spiked and the equity market has undergone a notable performance correction, credit markets have shown much more resilience. We show the recent spreads in high yields and loans (Fig. 6). While spreads are wider, movement has remained very contained. The volatility witnessed last summer due to the yen carry unwind created more volatility and spread widening, by comparison, than what we are witnessing today. The technical demand for yield, alongside stronger balance sheets and lower leverage, remains a tailwind to performance.

We maintain that the private credit market overall will remain healthy, particularly for those benefitting from strong fundamentals in the senior to upper-middle-market and sponsor-backed loans. The sponsor-backed, middle-market community has learned how to operate in a higher rate environment and ended 2024 on stable footing, supported by slightly lower all-in interest costs and stronger balance sheets driven by revenue growth.

Figure 6

Public credit spreads remain near all-time tights

	HY													LL				
As of: 3/10/2025	**HY**	**IG**	**AAA**	**AA**	**A**	**BBB**	**BB**	**B**	**CCC**	**HY-IG**	**BB-BBB**	**B-BB**	**CCC-B**	**LL**	**BB**	**B**	**CCC**	**BB-B**
Current	316	91	42	53	77	113	202	318	790	225	89	116	472	438	265	435	1473	390
2025 High	316	91	42	53	77	113	202	318	790	225	89	116	472	438	265	435	1473	390
2025 Low	259	79	32	44	66	98	156	260	667	180	58	104	407	414	248	419	1329	374
12M average	302	89	36	50	75	111	181	293	797	213	71	112	504	430	271	429	1243	388
US recession average	905	258	147	180	232	327	578	872	1987	647	251	293	1115	1191	786	1423	2323	774
US non-recession average	464	129	65	80	107	168	307	469	993	335	139	162	524	507	354	536	1302	441
% +/– US non-recession avg.	–32%	–30%	–35%	–34%	–28%	–33%	–34%	–32%	–20%	–33%	–36%	–28%	–10%	–14%	–25%	–19%	13%	–12%
% +/– US recession avg.	–65%	–65%	–71%	–71%	–67%	–65%	–65%	–64%	–60%	–65%	–65%	–60%	–58%	–63%	–66%	–69%	–37%	–50%

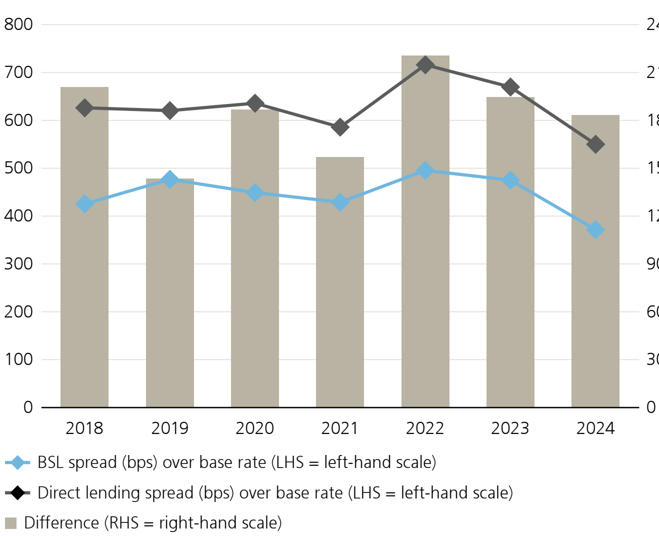
Source: ICE BofA, UBS, as of 10 March 2025

While the end of 2024 shows spreads compressed for both public and private markets (Fig. 7), there remains an ample pickup in spreads in direct lending, even accounting for the increased competition from banks returning to the marketplace.

On the private side, the spreads from the market peak in 4Q21, which witnessed a SOFR near zero that resulted in a much lower cost of capital and a more robust M&A market, are close to where we sat at the end of February, or around 500bps. Given last year's reopening of the public market, alongside ample dry powder, lenders may compete for new opportunities leading to improved deal terms for borrowers that are strong performers. For those stronger USD 40-100mn adjusted EBITDA businesses, spreads are near the levels we witnessed during the market peak in 2021, but yields are over 200bps higher, around 10% (Fig. 8). However, as we have discussed, like the tiering of the US consumer, it is a tale of two economies within private credit. Weaker performing loans with greater liquidity concerns clear at much wider spreads. However, in today's environment, while spreads have compressed and yields are lower than in 2023, so is the cost of capital. And with SOFR having trended lower in 2024, the fixed charge coverage ratio (FCCR) moved slightly over 1% in 4Q23 to 1.15% in 4Q24. The FCCR is one financial indicator which measures a company's ability to pay fixed costs. A ratio greater than one indicates financial stability. According to Lincoln International, the year-end 2025 FCCR is expected to reach 1.25%.

Figure 7

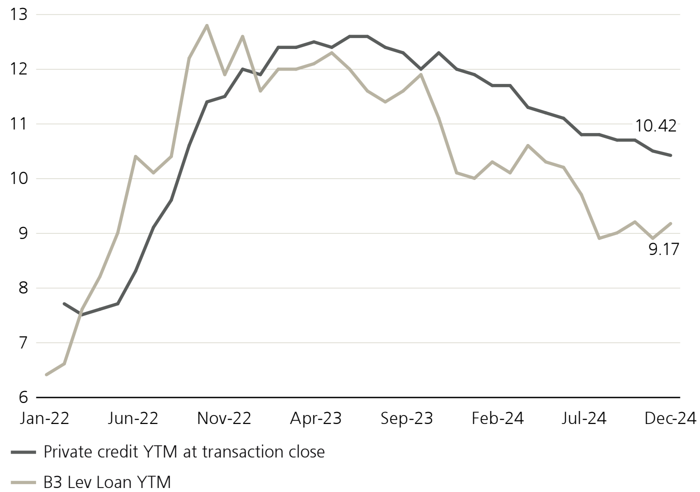
There remains a large spread differentiation between public and private markets



Source: PitchBook, UBS

Figure 8

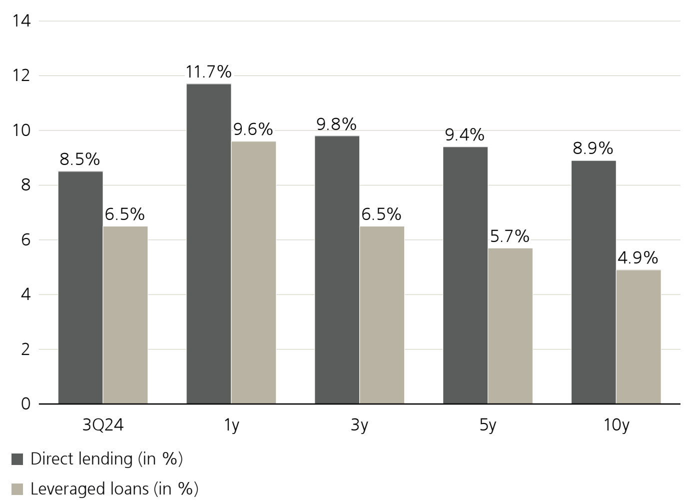
There is a 125bps gap between private credit and BSL yields. The long-term average is 100bps



Source: JP Morgan, UBS, as of 23 March 2025

Figure 9

Direct lending has steadily outperformed loans



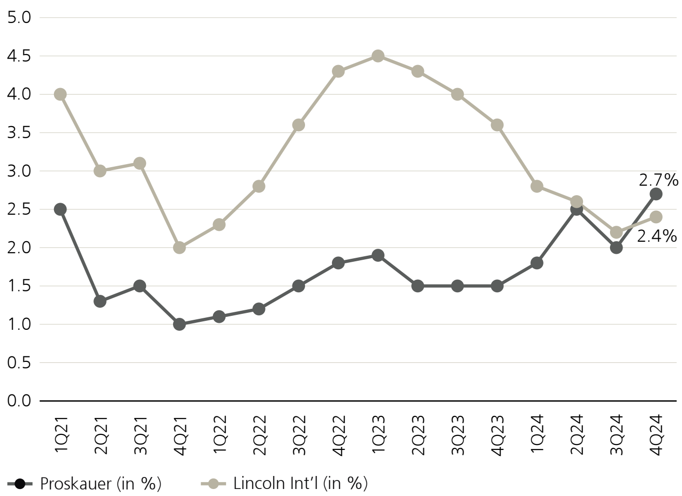
Source: Cliffwater, UBS, as of 30 September 2024

Performance trends

Private credit has continuously outperformed leveraged loans (Fig. 9) over the past several years. Covenants remain a material performance differentiation between the public and private markets. We recognize that reported defaults may differ across sources given the varying default definitions and the lack of a common sample universe; looking at covenant defaults where once the covenant breach is resolved it is no longer deemed as in default remains a common methodology for data providers such as Proskauer and Lincoln International. Proskauer, Lincoln, and Kroll reported 2024 default rates of 2.2–2.7% (Figs. 10 & 11)—lower than the public markets. More importantly, loss rates over the past 10 years remain much lower in direct lending versus high yield (Fig. 12).

Figure 10

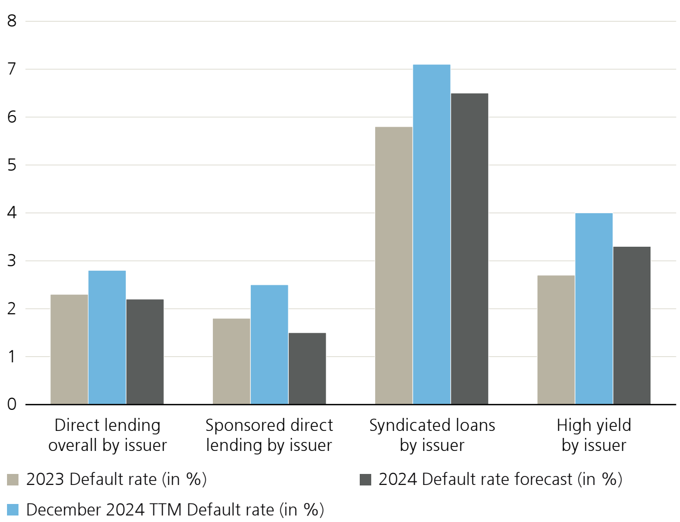
Both Proskauer and Lincoln Int'l see defaults rising



Source: Proskauer, Lincoln Int'l, Morgan Stanley, UBS, as of 10 March 2025

Figure 11

Direct lending defaults are below broader public markets



Source: KBRA DLD, UBS, as of December 2024

Figure 12

Loss rates in middle market have been historically low

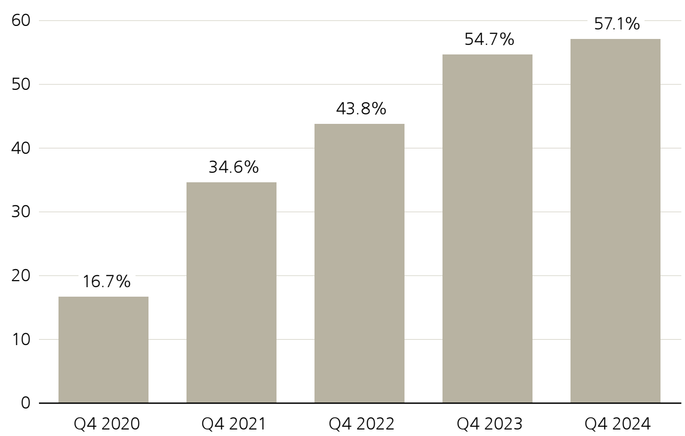
Category	Loss Rates over last 10 Years
Direct Lending	0.96%
High Yield Bonds	1.58%
Leveraged Loans	0.88%

Source: KBRA, UBS

PIKs, or pay-in-kind debt, allow a company to defer interest payments until a bond's maturity. Lower-tier middle-market borrowers tend to exhibit a higher non-accrual rate while upper-middle-market borrowers show a higher share of PIK interest. While PIK securities have been rising (Fig. 13), over the past several years defaults have remained stable. A recent Cliffwater report showed that PIK income has been a stable part of total income over the

Figure 13

The percent of securities with no PIK at deal close, but that now have PIK, has steadily risen



Source: PitchBook, UBS, as of 11 March 2025 last four years (Fig. 14). PIK income as a percent of total income is a way to measure higher risk—the higher the number, the higher the likelihood the borrower is converting cash interest to PIK taking on greater risk. Since the pandemic, the average has been ~7.5%, with late 2024 moving to the low 7% range. While we monitor shifting PIK activity, we do not currently view the overall rise as a point of concern given our expectation of lower interest rates and a lower growth outlook.

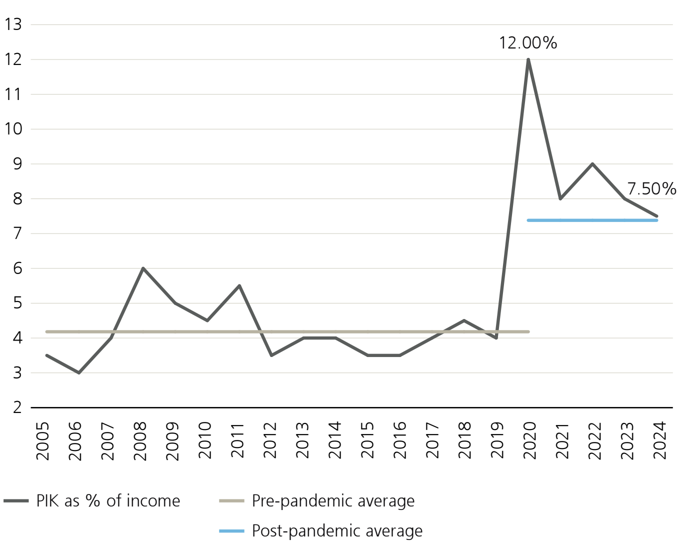
While we anticipate volatility in the public markets over the next several months, the trends in the private markets including FICC, PIK as a percent of income, and default rates are all trending in the right direction. Investors should be selective, but dry powder remains ample.

Private wealth and high-net-worth individuals

According to Blackstone, as of 2021 an estimated 2% of the USD 83tr in the global private wealth market is in alternatives. Long term, Blackstone projects private wealth allocation to alternatives will reach ~USD 10tr of private wealth allocation (Fig. 15), with 30–40% of that allocated to private credit: direct lending, asset-backed finance (ABF), and investment grade as well as customized BDCs (such as ETFs and interval funds). According to Bloomberg, forty-three new funds were registered in 2024, and interval fund AUM has grown to USD 89bn, up from USD 25bn just four years ago. This growth has enabled private credit platforms to access the near USD 9tr US 401(k) market. Hybrid funds are increasing in popularity for HNW individuals which combines private credit and private equity with the goal of providing investors income alongside potential equity appreciation.

Figure 14

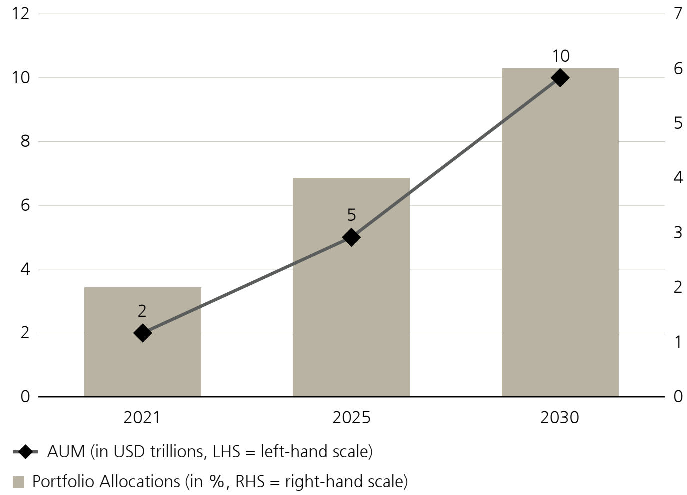
PIK as a percent of total income has been stable over the last several years



Source: Cliffwater, UBS, as of 11 February 2025

Figure 15

Private wealth management allocation to alts has risen and could reach USD 10tr in the next five years



Source: Blackstone, BofA, UBS, as of 11 March 2025

Conclusion

Going forward we continue to recommend private credit; however, manager selection is key. Manager dispersion is far greater in private credit than public credit, and manager performance tends to persist across top and bottom private-fund managers. With yields near 10%, low defaults, declining leverage, and ample covenants, alongside CIO's outlook for lower growth combined with two Fed cuts in 2H25, we remain constructive for the sector. With ample dry powder and lower sensitivity to market volatility, we continue to recommend private credit and anticipate outperformance versus its public counterpart.

Private real estate

Capital is the lifeblood of commercial real estate

Summary

- The most recent Federal Reserve Senior Loan Officer Opinion Survey on bank lending standards and demand for commercial real estate (CRE) loans is largely supportive of a better environment for multifamily and nonfarm, nonresidential lending, while construction and development is under significant pressure on both the supply and demand side. Although not great news for the development community, we view this trend as a positive for CRE values, particularly for industrial and multifamily, which have impressive long-term demand fundamentals but have been burdened by aggressive new supply.

- Both domestic and foreign banks are demonstrating an easing trend in CRE lending standards while also witnessing greater demand. However, segmenting banks by asset size indicates a bit more caution with larger banks on the lending side of the equation, while smaller banks are generally indicating a continued easing trend in lending standards.

- Banks account for almost 51% of total CRE loans outstanding with the largest concentration in banks with less than USD 20 billion in assets.

- Barring a significantly tighter regulatory environment for banks—something that we believe is unlikely under the current administration— or a severe recession, we believe overall bank CRE lending will continue to inflect positively in 2025.

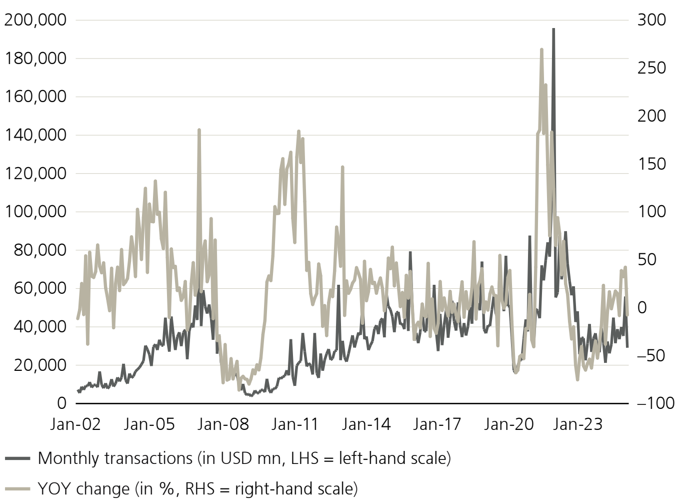
- A bottoming trend in a majority of CRE values began occurring in late 2024, and the results through January 2025 are encouraging.

Following several years of a moribund transaction market (Fig. 1) we believe CRE values and transaction activity are poised to begin rebounding in 2025.

In our opinion two key components that are necessary for transaction activity to increase are stability in interest rates and broad access to capital. Regarding interest rates, we believe the volatility in rates over the past two years (Fig. 2) has been a significant contributor to the dearth in transaction activity. Given the large number of independent variables that go into asset valuation clarity on capital costs are essential in the underwriting process.

Figure 1

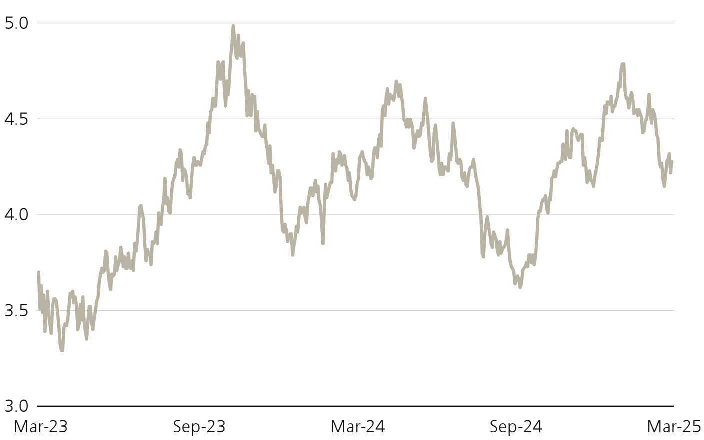
CRE transaction activity by dollar volume
Jan 2002-Jan 2025



Source: MSCI Real Capital Analytics, UBS

Figure 2

10-year Treasury yield trends
10 March 2023-11 March 2025



Source: FactSet, UBS

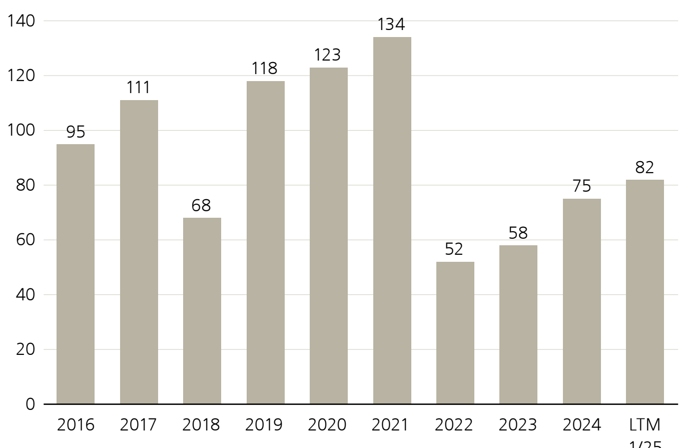
Capital availability – Cycles matter

In our view, one of the most dangerous phrases in the investment business is "it's different this time." What we believe is that every cycle has its differences. One of the hallmarks of the global financial crisis (GFC) was an effective shutdown of the global capital markets. REITs/CRE investors had virtually no access to the equity and unsecured debt markets, banks were pulling lines of credit, and REIT/CRE balance sheets were largely more heavily leveraged and often contained puttable debt and preferred stock.

Conversely, the current cycle is dramatically different from the GFC. REIT balance sheets by and large are in impressive shape with significantly lower leverage and solid access to capital. In 2024 REITs raised USD 85bn in equity and unsecured debt—more than 140% of the levels in 2022 and 2023 (Fig. 3). In addition, borrowing spreads in the unsecured debt market have tightened considerably with the highest quality borrowers realizing spreads less than or equal to 100bps over the base rate. Further,

Figure 3

REIT capital issuance 2016-LTM January 2025
(USD in billions)

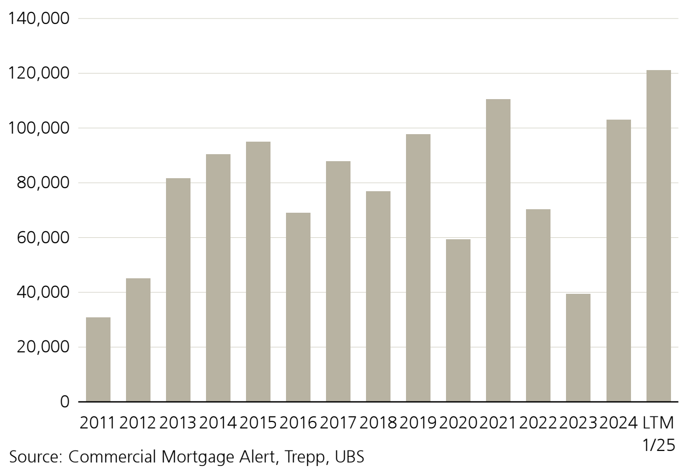


Source: SNL Financial, NAREIT, UBS

the CMBS market is very favorable to CRE with 2024 issuance almost triple 2023's issuance (Fig. 4), and 2025 is off to a strong start with a solid pipeline of deals at attractive borrower spreads.

Figure 4

CMBS issuance 2011-LTM February 2025 (in USD millions)



Source: Commercial Mortgage Alert, Trepp, UBS

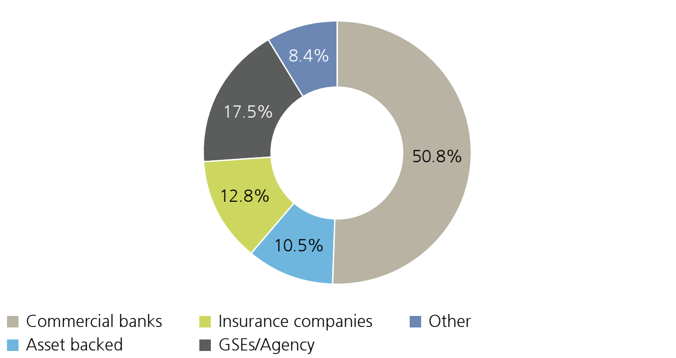
A deep dive on bank CRE lending

Accounting for more than 50% of CRE debt outstanding (Fig. 5), the outlook for bank lending to the CRE market is crucially important, particularly given that approximately USD 1.6 trillion of CRE debt is set to mature in 2025 and 2026 with some 47% of that figure comprising bank loan maturities (Fig. 6).

Each quarter the Federal Reserve (the Fed) publishes its Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS). The SLOOS addresses changes in the standards and terms on,

Figure 5

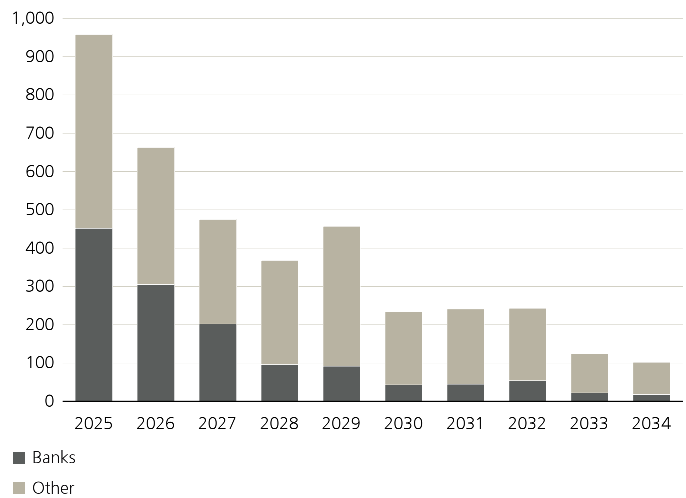
Commercial real estate debt outstanding by source as of December 2024



Source: Federal Reserve, Mortgage Bankers Association, UBS

Figure 6

CRE mortgage debt maturities 2025-34 (USD in billions)



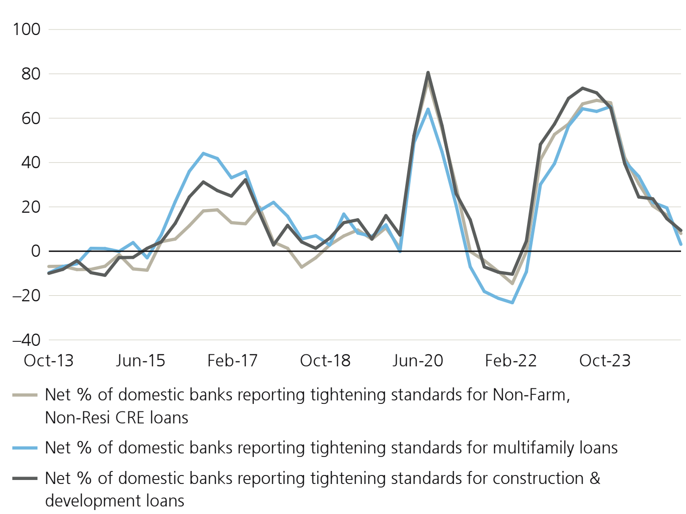
Source: Federal Reserve, Mortgage Bankers Association

and demand for, bank loans to businesses and households over the prior three months. The SLOOS is segmented by different categories including all domestic banks, all domestic banks segmented by large banks and other banks, and foreign banks.

As can be seen in Fig. 7 the percentage of domestic banks tightening lending standards for non-farm, non-residential multifamily,

Figure 7

SLOOS for domestic bank CRE lending standards through December 2024

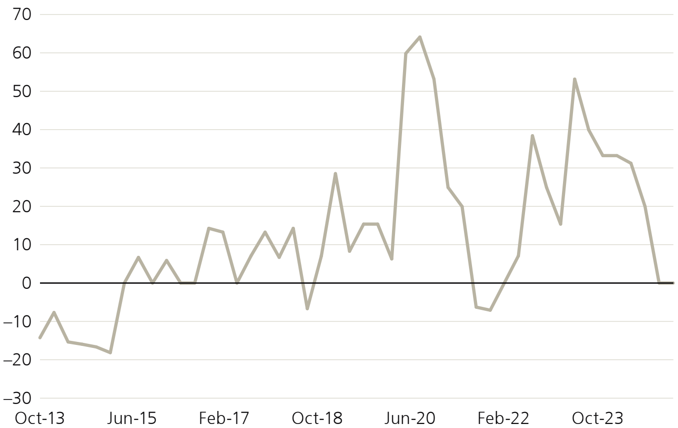


Source: Federal Reserve, UBS

and construction & development loans declined throughout 2024. In addition, the percentage of foreign banks tightening lending standards for CRE loans showed a similar trajectory to domestic banks (Fig. 8).

Figure 8

SLOOS for foreign bank CRE lending standards through December 2024



Source: Federal Reserve, UBS

We believe it is important to segment this data further given that a significant percentage of the outstanding CRE debt that is held by banks with less than USD 20bn in assets (Fig. 9).

Figure 9

Outstanding CRE bank debt segmented by bank asset-size data as of 4Q24

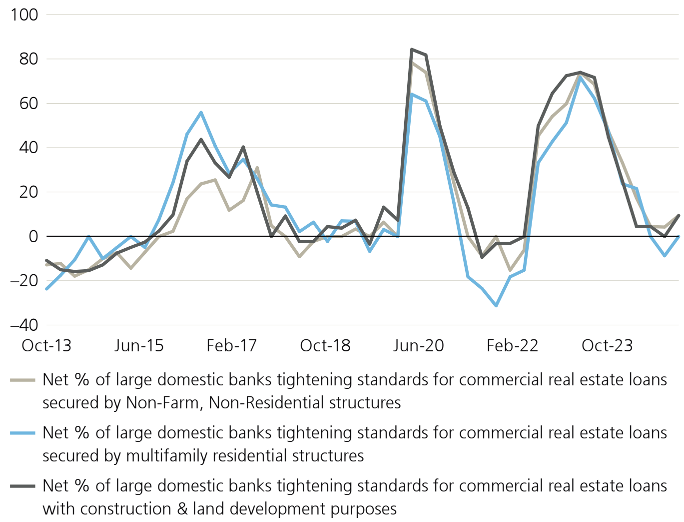
	As of 4Q 2024		
Bank Asset Base	**Total CRE Loans Outstanding $000**	**% of Total Bank CRE Loans Outstanding**	**% of Total CRE Loans Outstanding**
> $250BN in Assets	$653,091,281	21.8%	11.0%
$100BN-$250BN in Assets	$149,734,825	5.0%	2.5%
$20BN-$100BN in Assets	$409,763,223	13.7%	6.9%
< $20BN in Assets	$1,787,410,671	59.6%	30.0%

Source: SNL Financial, UBS

For the SLOOS survey the Fed defines large banks as those with more than USD 100bn in assets and other banks as those with less than USD 100bn in assets. As the data in Fig. 9 indicate, banks with less than USD 100bn in assets held 73.3% and 36.9% of total bank CRE debt and total CRE debt, respectively, as of 4Q24. When we segment the domestic bank lending standards some differences begin to emerge. As can be seen in Fig.10, large banks have begun to tighten lending standards a bit following a steady decline over the past 5-6 quarters, whereas other banks have continued on the path of easing lending standards (Fig. 11).

Figure 10

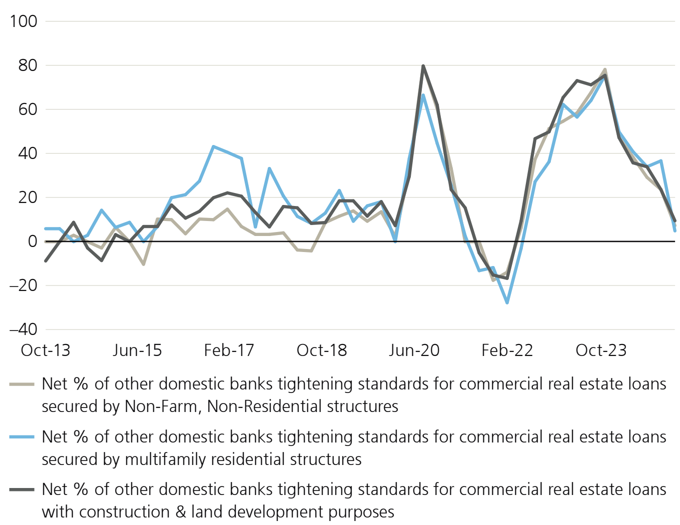
SLOOS for large domestic bank CRE lending standards through December 2024



Source: Federal Reserve, UBS

Figure 11

SLOOS for other domestic bank CRE lending standards through December 2024



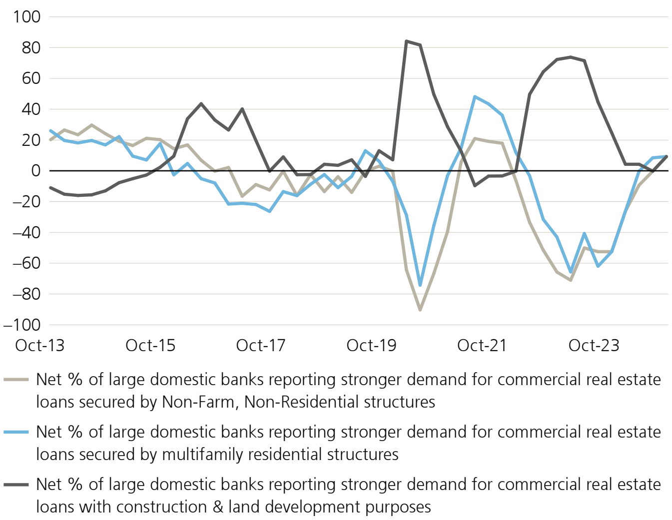
Source: Federal Reserve, UBS

To be clear, we are not saying that smaller banks are opening the lending spigot for CRE and abandoning their lending standards. Rather they are normalizing lending standards following a period of significant tightness. Smaller banks' outsized exposure to total CRE loans potentially points to an increased ability for CRE borrowers to refinance and/or initiate new loans.

Looking at the demand side of the equation across both large and other banks, an interesting trend has developed over the past several quarters. As can be seen in Figs. 12-13 the demand for multifamily and nonfarm, nonresidential loans has increased while the demand for construction & development loans has steadily decreased.

Figure 12

SLOOS demand trends for large domestic bank CRE through December 2024



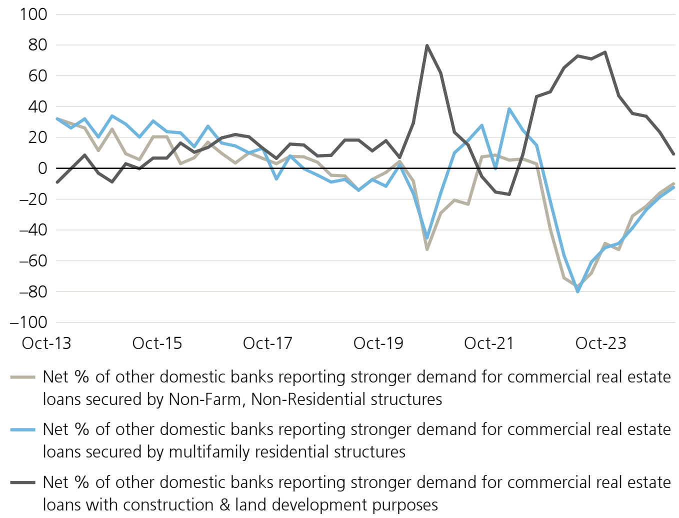
Source: Federal Reserve, UBS

We believe the decline in the demand for construction & development CRE loans is the result of factors including, but not limited to the following:

- The cost of construction capital (base rate plus spread) and construction materials does not allow for many new construction deals to pencil, particularly given current rents in a number of asset classes.
- There has been a significant decline in new construction starts for retail, senior housing, and office which was already evident pre-COVID. In addition, multifamily and industrial, which experienced significantly elevated construction starts in 2019-22 has seen new start activity decline precipitously over the past several quarters as recent deliveries are still being absorbed by the market.
- Lenders are more carefully scrutinizing construction loans, requiring significantly more equity (lower loan-to-cost levels), higher debt service coverage ratios and interest reserves, as well as the purchase of interest rate caps that have become significantly more expensive in conjunction with the Fed's aggressive monetary policy being much more vigilant about financing speculative projects.

Figure 13

SLOOS demand trends for other domestic bank CRE through December 2024



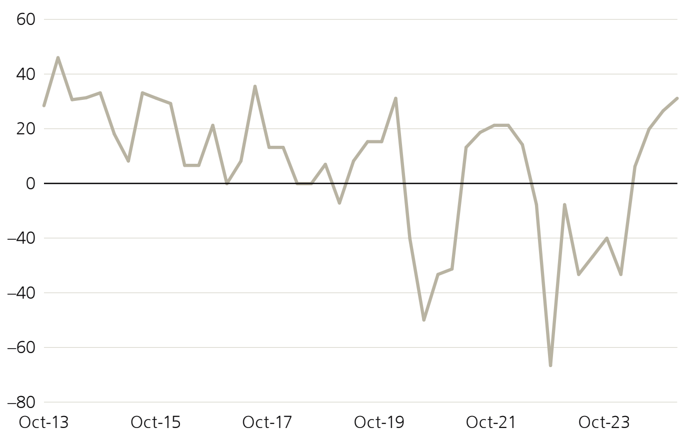
Source: Federal Reserve, UBS

Although not great news for the development community, we view this trend as a positive for CRE values, particularly for industrial and multifamily which have impressive long-term fundamentals but have been burdened by aggressive new supply as well as by retail, which continues to benefit from the lack of new supply which, in turn, has allowed owners of retail real estate to more quickly backfill boxes at substantially higher rents left vacant by bankrupt tenants.

Like domestic banks, foreign banks have experienced a sustained uptick in demand for CRE loans (Fig. 14).

Figure 14

SLOOS demand trends for foreign bank CRE through December 2024



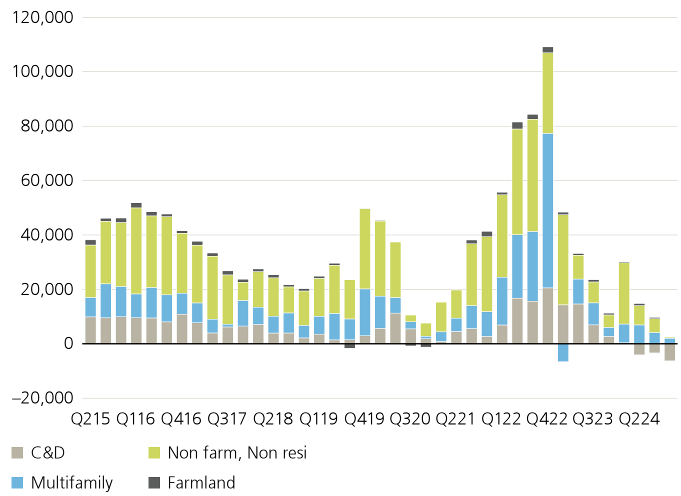
Source: Federal Reserve, UBS

An important point to be considered from the survey results is the sample size of survey respondents. The total number of respondents for all banks was 63, composed of 21 for large banks and 42 for other banks. Given the consolidation in the bank sector post the global financial crisis, the number of large banks (> USD 100bn in assets) makes sense. That said, given that there are more than 4,000 banks in the US, a sample size of 42 other banks may not present a complete picture. Although we believe the results are directionally instructive, they may not encompass the entire lending and demand picture for smaller banks.

Based on the data presented above, we believe a reasonable question would be: Why aren't we seeing stronger demand and easing lending standards being reflected in bank CRE loan volumes? As can be seen in Fig. 15 the dollar volume of bank CRE lending declined in each quarter in 2024. We believe the answer lies in the composition of CRE loans. As can be seen in Fig. 16, construction and development actually retrenched year over year in 2023-24. Conversely, multifamily, nonfarm, nonresidential, and farmland lending were all positive, albeit lower than 2023 levels.

Figure 15

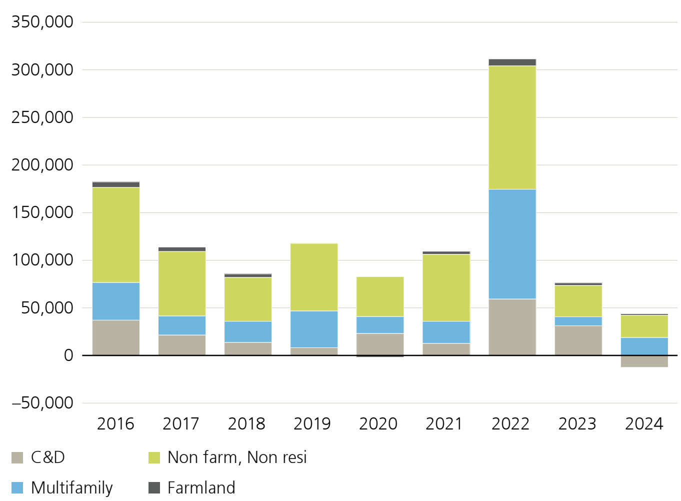
Bank CRE lending trends 2Q15 – 4Q24 (in USD millions)



Source: Federal Reserve, UBS

Figure 16

Bank CRE lending by loan type 2016-24 (in USD millions)



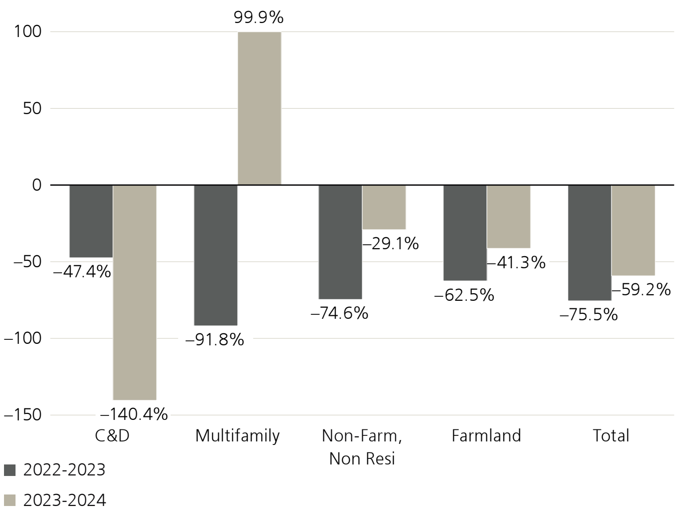
Source: Federal Reserve, UBS

In addition, the data in Fig. 17 highlight the year-over-year percentage change in bank lending by loan type from 2022-23 and 2023-24. As the data indicate, construction & development lending has declined precipitously, multifamily lending completely reversed course in 2024 and increased substantially, while both nonfarm, nonresidential, and farmland lending improved significantly.

Barring a significantly tighter regulatory environment for banks—something that we believe is unlikely under the current administration— or a severe recession, we believe overall bank CRE lending will continue to inflect positively in 2025. As can be seen in Fig. 18 a bottoming trend in a majority of CRE values began occurring in late 2024 and the results through January 2025 are encouraging.

Figure 17

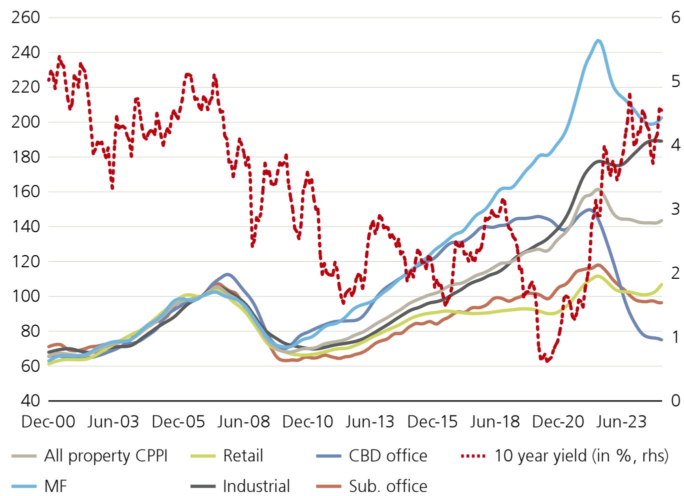
Percentage change in bank CRE lending by loan type 2022-23 and 2023-24



Source: Federal Reserve, UBS

Figure 18

Moody's Commercial Property Price Index December 2001 – January 2025



Source: MSCI Real Capital Analytics, UBS

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