

## Sector spotlight: Subordinate debt

The best evergreen strategies in commercial real estate provide a consistent, tax-advantaged income stream that grows faster than inflation, offering the investor both income and appreciation. Typically, this is achieved by constructing a portfolio of assets that have strong competitive positions, are insulated from supply threats, and are located in demographically attractive areas and sectors where demand is growing faster than inflation.

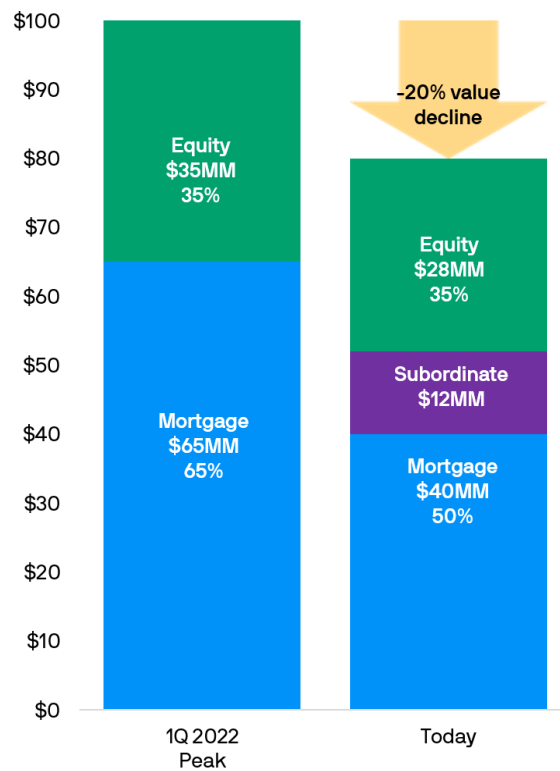
So, why would an evergreen strategy invest in debt? With debt instruments, the income can be attractive, but when the loan matures, the best outcome is no appreciation.

In today's market, senior loan proceeds are typically lower than they would have been in a lower rate environment. As a result, many property owners are faced with the need to come up with more equity when they refinance an asset. Alternatively, they can seek gap financing, often called subordinate debt (think of it as a second mortgage) as shown in the chart on the right. In most property sectors, if the fundamentals are strong, the subordinate debt can be sized to a very comfortable basis. This means that if the borrower defaults on the loan, the subordinate investor can assume ownership at a cost that is very attractive both by historic measures and relative to replacement cost. The returns on these subordinate loans can often exceed 10%, offering equity-like returns with debt-like risk.

The trouble with subordinate debt funds for individual investors is that subordinate debt income is taxable income. Therefore, the after-tax return on 10% income becomes unattractive relative to other investments. However, most non-listed REITs own a majority of direct properties. The taxable income from these properties can often be offset by depreciation, resulting in after-tax returns for individual investors equivalent to or sometimes slightly lower than the REIT's pre-tax income. For REITs that generate more depreciation than income, there is room to do some subordinate debt investing while still maintaining their tax-advantaged income stream.

Not only are there tax advantages to doing some subordinate debt investing in a REIT, but the extra income yield that subordinate debt provides also helps boost the REIT's income return. This frees up capital to invest in more value-creation activities that boost appreciation. In properties where a REIT manager has particular expertise in managing risks such as leasing, renovations, or development, a REIT may invest in an asset that could generate returns in excess of its target return but may have less income in the first year or two of ownership. A subordinate loan elsewhere in the portfolio could help offset the lower income generated by that asset, enabling the REIT to continue to pay an attractive dividend. This is all to say that REITs can utilize subordinate debt to enhance total returns without sacrificing its consistent income yield.

JPM estimates that reduced proceeds creates funding gap



Source: J.P.Morgan Asset Management. This is a hypothetical chart showing estimates of the capital structures extant in 1Q 2022 compared to today.

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#### Summary of Risk Factors

An investment in shares of common stock of J.P. Morgan Real Estate Income Trust, Inc. ("JPMREIT") involves a high degree of risk. These securities should only be purchased if you can afford to lose your complete investment. Please read the prospectus for a description of the material risks associated with JPMREIT. These risks include but are not limited to the following:

- We have a limited operating history and there is no assurance that we will be able to successfully achieve our investment objectives.
- This is a "blind pool" offering. You will not have the opportunity to evaluate our future investments before we make them.
- Since there is no public trading market for shares of our common stock, repurchase of shares by us will likely be the only way to dispose of your shares. Our share repurchase plan provides stockholders with the opportunity to request that we repurchase their shares on a monthly basis, but we are not obligated to repurchase any shares and may choose to repurchase only some, or even none, of the shares that have been requested to be repurchased in any month. In addition, repurchases will be subject to available liquidity and other significant restrictions. Further, our board of directors may make exceptions to, modify or suspend our share repurchase plan if in its reasonable judgment it deems such action to be in our best interest and the best interest of our stockholders. Our board of directors cannot terminate our share repurchase plan absent a liquidity event which results in stockholders receiving cash or securities listed on a national securities exchange or where otherwise required by law. As a result, our shares should be considered as having only limited liquidity and at times may be illiquid.
- Distributions are not guaranteed and may be funded from sources other than cash flow from operations, including, without limitation, the sale of or repayments under our assets, borrowings, return of capital, offering proceeds and advances or the deferral of fees and expense reimbursements, and we have no limits on the amounts we may pay from such sources.
- The purchase price and repurchase price for shares of our common stock are generally based on our prior month's NAV (subject to material changes as described in the prospectus) and are not based on any public trading market. While there may be independent valuations of our properties from time to time, the valuation of properties is inherently subjective, and our NAV may not accurately reflect the actual price at which our investments could be liquidated on any given day.
- We are dependent on the Adviser, as well as persons and firms the Adviser retains to provide services on our behalf, to conduct our operations. The Adviser will face conflicts of interest as a result of, among other things, the allocation of investment opportunities among us and Other J.P. Morgan Accounts (as defined in the prospectus), the allocation of time of its investment professionals and the substantial fees that we will pay to the Adviser.
- This is a "best efforts" offering. If we are not able to raise a substantial amount of capital in the near term, our ability to achieve our investment objectives could be adversely affected. In addition, we are not required to call all of the commitments for our private offering and cannot guarantee that any capital commitments requested thereunder will be funded.
- Principal and interest payments on any borrowings will reduce the amount of funds available for distribution or investment in additional real estate assets.
- There are limits on the ownership and transferability of our shares.
- If we fail to qualify as a REIT and no relief provisions apply, our NAV and cash available for distribution to our stockholders could materially decrease.

#### Forward Looking Statements

This material contains forward-looking statements about the real estate market and the subordinate debt sector within the real estate market. These forward-looking statements can be identified by the use of forward-looking terminology such as "expect," "continue," "may," "will," "should," "anticipate," "intend" or other similar words or the negatives thereof. These may include statements about plans, objectives, intentions, and expectations with respect to positioning within the real estate market, including the impact of macroeconomic trends and market forces. Such forward-looking statements are inherently uncertain and there are or may be important factors that could cause actual outcomes or results to differ materially from those indicated in such statements. We believe these factors include but are not limited to those described under the section entitled "Risk Factors" in JPMREIT's annual report for the most recent fiscal year, and any such updated factors included in JPMREIT's periodic filings with the SEC, which are accessible on the SEC's website at [www.sec.gov](http://www.sec.gov). These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in JPMREIT's public filings. Except as otherwise required by federal securities laws, JPMREIT undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments or otherwise.

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