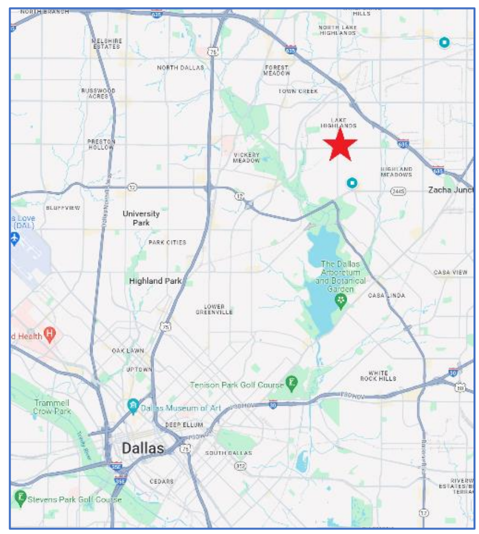
ClearWorth Capital

Q4 2024 Investment Update
Lavera at Lake Highlands

9842 Audelia Rd, Dallas, TX 75238



Lavera at Lake Highlands
Q4 2024 Investment Update
(Prepared on February 18, 2025)

<u>Property Description:</u> Lavera at Lake Highlands, located in Dallas's Lake Highlands area, is a 280-unit garden-style apartment community with a diverse mix of floor plans, including 48 one-bedrooms (17%), 190 two-bedrooms (68%), and 42 three-bedrooms (15%). These units are generously sized, averaging 1,024 square feet of living space. Residents can access various amenities, such as a clubhouse with a fitness center, a children's playground, a bocce ball court, a resort-style swimming pool with grilling/BBQ stations, and an outdoor fire pit. Situated on a premium infill site at a busy four-way intersection, Lavera enjoys high visibility to street traffic and is surrounded by newly constructed single-family homes, upscale apartment buildings catering to higher-income demographics, and various popular neighborhood retail options.

In August 2023, we acquired this property for $33.3 million, equivalent to $119K per unit, to renovate, reposition, stabilize, and sell it within 3 to 5 years. The renovation budget totals $5.3 million, with $3.0 million allocated for capital improvements and $2.3 million designated for interior upgrades.

Asset Type:	Conventional Multifamily	**Acquisition Date**:	08/30/2023
Units:	280	**Equity Contributions:**	$14,739,940
Vintage:	1970 / 2014	**Equity Distributions** (through 12/31/24)**:**	$-
Land Acres:	14.1 (20 units/acre)	**Debt Balance** (as of 12/31/24)**:**	$25,777,827

CURRENT UPDATES

<u>Key Comments for the Quarter</u>

- The local submarket is still soft, but we are making strides as the Rent Roll is rising.
- Our renewal percentage is outstanding, which is a testament to our operational efforts.
- The property looks great. It has looked better and better in recent quarters.
- We bound insurance in Q1 2025 resulting in a 57% favorable variance to what was underwritten!
- We are still hopeful rates will come down into 2025, though they have bumped up recently.
- Overall, we are a "hold" on this asset as we continue to build value.

<u>Property Operations</u>

Both revenue and expenses increased in 3Q 2024 by 1% and 10%, respectively, producing a negative 15% decrease in NOI from the prior quarter. The increase in expenses is entirely driven a tax true up as property tax for 2024 was higher than previously expected. We will file a suit to argue our tax basis.

Leasing activities in Q4 included 28 move-ins, 28 move-outs, and 30 signed renewals, which kept occupancy flat from Q3 at 90%. The average rental rates for move-ins and renewals were $1,1448 and $1,456, respectively, raising the property's overall rental average to $1,424, reflecting 7% growth during the first 13 months of our ownership.

<u>Interior Upgrades</u>

In Q4, we completed upgrades to 17 units, bringing the total number of upgraded units to 111, or 40% of the property. Each renovation has cost an average of $16.9K and has taken an average of 25 days to complete. As of December 2024, these renovated units generate average rents and supplemental charges totaling $1,457, representing a $134 or 11% premium over non-renovated units. We plan to continue renovations until approximately 140 units, or 50% of the property, have been upgraded.

Capital Improvements
As of December 2024, we have drawn approximately 77% of the exterior renovation budget. These funds have been utilized to refresh all building exteriors with new paint and trim, re-furnish the resident clubhouse, business center, and fitness center, resurface the community swimming pools, renovate one communal laundry facility and a new model unit. Additionally, we addressed several deferred maintenance items, including a full roof replacement, extensive electrical and lighting repairs, tree trimmings and removals, and the repair of trip hazards. In 4Q2024 we completed waterproofing 4 buildings to improve drainage; replacement of dented doors around the property; boiler repairs and replacements as needed; and the addition of grilling stations, FF&E, a bocce ball court, and corn toss area to common areas around the property. These enhancements have significantly elevated Lavera at Lake Highlands' appearance and market positioning, as showcased in the impressive photos on laveraliving.com.

Loan Summary
Lavera is secured by a primary mortgage from Gateway First Bank, a Dallas-based community bank that also finances ClearWorth's adjacent property, Lakeridge Heights. The loan consists of an acquisition note for $21.67 million and a renovation note for $5.27 million, totaling a commitment of $26.94 million. It carries a fixed interest rate of 7.0% and permits interest-only payments until December 2025. After this period, the loan will transition to principal and interest payments based on a 30-year amortization schedule, with maturity set for August 30, 2026.

As of December 2024, $4.2 million has been drawn from the renovation note, leaving approximately $1 million available for further property enhancements.

U.S. Apartment Sector Overview
Operating Fundamentals
The U.S. multifamily market continued a strong rebound in demand during the fourth quarter of 2024, with 110,000 units absorbed. That brings full-year demand for 2024 to 553,000 units, the strongest total since 2021. Additionally, that was a 68% increase over 2023's total. Demand was driven by stable economic growth, slowing inflation, and a continued slowing of renter households making the jump to ownership. And while supply additions have outpaced demand over the past 3 years, the gap has closed significantly in the second half of 2024. In the fourth quarter, the supply/demand gap only totaled 24,000 units, the smallest amount since the end of 2021. This shrinking of the supply/demand gap held the vacancy rate steady at 8.0%. It's the first time in three years that the vacancy has remained unchanged from quarter to quarter. Furthermore, it is projected that the vacancy rate has peaked and will begin to decline during the second half of 2025.

Additionally, overall rent growth has stabilized and may be on the cusp of expanding. Rent growth held steady at 1.0% during the fourth quarter and has remained close to that number for the past six quarters. Thus, with the vacancy rate's rise appearing over, conditions appear ripe for rent growth in 2025.

Nevertheless, rent conditions at different price points show unique outcomes. Most new supply additions are concentrated at the class A price point, contributing to the weakest rent growth observed at the market's upper echelon. In the fourth quarter, class A properties recorded rent growth of 0.2%, and this segment is projected to remain the weakest for the foreseeable future. At the same time, mid and lower-priced properties experienced rent growth that outpaced the overall average. During the fourth quarter, B class properties experienced steady rent growth at 1.3%, while C class buildings exhibited the highest growth of 1.9%. The outlook for 2025 indicates that accelerating rent growth will come first in the B and C class segments due to increasing demand and limited supply pressure in these price points. This trend is at the very heart of ClearWorth's value-add strategy. Our portfolio, which is primarily B class product, takes advantage of the supply economics that began during Covid: development of best-in-class properties hoping to achieve record-breaking rents. Being nestled just below these trophy assets and above C class product that can be difficult to operate, the portfolio is poised to take advantage of the growing working class renter base.

Market fundamentals are also highly varied depending on region. For the most part, Midwest and Northeast markets have experienced only moderate supply additions over the past two years, contributing to a more balanced multifamily sector in these regions. Consequently, they have exhibited the most favorable rent growth. At the same time, rent growth has been sluggish in the Sun Belt, with numerous markets reporting negative year-over-year rent growth.

2024 saw 677,000 completions for the year, the highest total since the mid-1980s. However, 2025 will experience a steep forecasted 50% decline in deliveries to 346,000 units. If absorption can maintain the strong pace set year to date, demand will finally overtake supply in 2025. In that case, the overall market will have the opportunity to begin recovering, and by the end of 2025, overall rent growth could approach the mid 3.0% range.

Capital Markets

Fourth quarter of 2024 was highlighted by the election of the 47th President of the United States, Donald Trump, who campaigned on a promise to streamline and maximize performance of the country's economy. Roughly 40% of votes said the economy was their top issue, which is interesting given the robust growth achieved so far this year: the Nasdaq rallied 30%, the S&P climbed over 24%, and the Dow Jones rose a more modest 13%. During the same period, however, interest rates remained roughly double their historic low – 3% – in 2021. The outcome of the election has been marked by continued volatility in both rate and transaction markets.

Whereas cost of borrowing was on the decline in 3Q2024, uncertainty regarding the new administration's inflationary policies, specifically its broadcasted tariff strategies have pushed bond yields to the upper end of their two-year range as investors have been dumping Treasurys in favor of higher-yielding alternatives. The 10-year Treasury note jumped up to 4.619% compared to 4.192% in November and 3.860% at the beginning of the year. While some economists have adopted the belief that the economy can handle higher rates and that inflation will persist as a threat, others are weighing relatively lofty stock valuations with the downward movement of bond prices. Robert Shiller has concluded that historically, when the stock market cap balloons amid falling bond prices, it has meant that the former struggles to outperform the latter over the following 10 years. This trend makes an argument for rate relief at some point in the future, however Trump's policy will remain a large factor in exactly when this relief will be felt.

The consumer price index reached 2.7% on an annual basis in November, up 10 bps from October, spurred primarily by shelter expenses such as rent. Comparatively, food costs rose 0.4% annually while energy costs fell 3.2% for the year. According to Oxford Economics, the labor market is balanced, and nominal wage growth is running consistently with the Federal Reserve's inflation target of 2%. Food and beverage services, healthcare and construction remain the top areas of job gains, which all added a combined 127,000 positions. While the labor market resiliency may not be enough for the Fed to continue its path of rate cuts, it is anticipated to bode well for property owners by way of occupancy and rent stabilization.

In combination with the rate environment, new supply deliveries have put upward pressure on cap rates, leading to an 8.3% decline in property values nationally. The pricing correction has been felt considerably by 11 of the top 25 metropolitan markets, which each saw a slide in transaction values north of 10%. Specifically, Dallas-Fort Worth and Houston are the two markets with the highest gross supply increase in the past 5 years vs. the prior 5-year period. The Sun Belt continues to lead the country in production, as Houston and DFW have added 100,000 and 150,000 units, respectively during that timeframe.

However, over the last several quarters, national multifamily prices have remained stable. The value-weighted repeat- sale index for multifamily properties from CoStar shows the deepest drop occurred in March 2024, with prices 27% below the all-time highs of 2022. Since the end of the first quarter, price declines have come in, suggesting that these losses may have been arrested. The U.S. multifamily picture appears to be turning a corner, as last year's transaction volume ticked higher compared to 2023. After consistently improving deal volume through each quarter, transaction volume was up 18% year-over-year to $102 billion in 2024. Transaction counts also showed improvement, with 10,516 deals in 2024, up 7% from the year prior.

Overall, the Apartment Investment Market Index, which is a measure of the financing conditions created by lending giant Freddie Mac, has grown on a yearly basis in four straight quarters for the first time in 2021; it topped out at

2.2% year-over-year growth in 2024. Despite being roughly 10% below the 10-year average, this continued growth signifies the endurance of the multifamily sector and relatively unwavering demand for property investment.

Looking ahead, the balance of risk for 2025 remains somewhat neutral. On the one hand, above-trend absorption is expected to overtake supply, holding vacancy rates in place. But, despite the recent efforts by the Federal Reserve to bring interest rates down, fixed- rate financing costs have risen in recent months and could act as a wet blanket smothering the market's recovery. This tug-of-war may be short-lived as new supply deliveries are expected to taper off substantially in late 2025 and 2026. Until then, price discovery remains caught between improving fundamentals and higher long- term interest rates.

Local Market Overview (Dallas-Fort Worth)

Entering 2025, the Dallas-Fort Worth multifamily market is on a path toward rebalancing after surging supply last year. Developers added 40,000 units in the past year, the highest level on record. Meanwhile, renter demand accelerated thanks to easing inflation and improving consumer confidence, but net absorption of 29,000 units fell short of deliveries, keeping vacancy elevated. At 11.4%, the vacancy rate is up 90 basis points year-over- year and holding near a 20-year high. Under the weight of new supply, rent growth remains negative at -1.2%.

While the supply-demand imbalance has prevailed, supply is downshifting with declining construction starts. Builders broke ground on just 21,500 units in the past year, the lowest level in a decade, setting the stage for the market to be more supply-constrained as the elevated cost of capital and softer property performances dissuade developers from pursuing new projects.

As the supply picture turns a corner, demand is led by fast-growing suburban submarkets, fueled by continued population gains in Collin and Denton Counties. Centered in both counties, Frisco/Prosper and Allen/McKinney account for a third of market demand in the past year and have helped stabilize the market during periods of heavy supply. Collin and Denton Counties have fueled population growth in Dallas-Fort Worth, expanding their resident bases by 50% since 2010.

Tracing new supply and submarkets with demographic tailwinds, demand is concentrated in the 4 & 5 Star segment, totaling 26,000. Meanwhile, demand is returning in mid-priced units after a pullback two years ago that led to expanding vacancy rates. Demand in the mid-tier 3 Star segment totaled 3,700 units in the past year, though the vacancy rate for 3 Star properties remains stubbornly high. At 11.5%, vacancies for 3 Star properties remain above the pre-pandemic average of 6% and reflect the residual impact of higher prices within mid-to-lower income renter households even as the pace of inflation has eased.

Rent growth remains negative as supply outstrips demand and performances are stratified by quality. High- end, 4 & 5 Star properties reported rent declines of -1.4%, reflecting greater sensitivity to pricing power among new competition. Meanwhile, mid-priced, 3-Star rents have slipped -1.2% in the past year for the first time since the end of the Great Financial Crisis.

Eroding rents have spread to submarkets adjacent to construction hot spots as owners and property managers compete for demand. Battling for residents, the share of properties offering concessions has risen above 50%, with six to eight weeks free as the norm, according to market participants.

In the near term, the outlook calls for vacancies to peak in 2025 as supply and demand shift closer to equilibrium with rents remaining mostly muted this year given the surge in deliveries in the past year. Even so, the sharp decline in construction starts is laying the foundation for vacancies to retighten and rents to rebound in 2026.

Partner Distributions

The property is expected to distribute funds regularly beginning as soon as we reset all our lender required tax and insurance escrows to reflect recent savings.

Rent Roll & Leasing Trends	4Q2023	1Q2024	2Q2024	3Q2024	4Q2024
Average In-Place Rent	$1,364	$1,382	$1,398	$1,415	1,423.92
End of Quarter Occupancy	85.7%	85.0%	86.8%	90.4%	90.4%
Renovated Units	12	60	86	101	111
Occupied Renovated Units	6	44	68	85	106
Average In-Place Renovated Rent	$1,377	$1,827	$1,622	$1,639	$1,457
Move-Ins	26	46	45	44	27
Average Move-In Rent	$1,438	$1,397	$1,434	$1,478	$1,448
Signed Renewals	34	20	31	41	30
Average Renewal Rate	$1,380	$1,333	$1,433	$1,351	$1,456

Trailing Income Statement	4Q2023	1Q2024	2Q2024	3Q2024	4Q2024
Revenue	$1,146,047	$975,186	$1,133,533	$1,221,588	$1,236,564
Operating Expenses	$763,736	$726,014	$705,738	$802,285	$876,878
NOI	**$382,311**	**$249,172**	**$427,795**	**$419,303**	**$359,686**
Debt Service	$394,334	$401,383	$427,736	$449,123	$458,867
NOI less Debt Service	**-$12,023**	**-$152,211**	**$59**	**-$29,820**	**-$99,181**
NOI Margin	33.36%	25.55%	37.74%	34.32%	29.09%