NEXPOINT

2020 Commentary

# NexPoint Strategic Opportunities Fund

During 2020, the NexPoint Strategic Opportunities Fund (the "Company", NYSE:NHF) returned -12.52% on net asset value ("NAV") and -33.46% of market value, including reinvested dividends, compared to a total return of 6.34% for the Credit Suisse Hedge Fund Index and 6.79% for the HFRX Global Hedge Fund Index during the same period. Top contributors to performance included market hedges. The largest detractors to performance included real estate positions in hospitality and office.

On August 28, 2020, shareholders approved the proposal to convert the Company from a registered investment company to a diversified real estate investment trust ("REIT"). The Company will begin to transition its business and investments to those of a diversified REIT. With the conversion, NHF will be the fourth publicly traded REIT on the NexPoint platform. We believe converting the Company to a REIT provides several benefits to shareholders including: 1) The potential to provide investors with a superior risk adjustment return compared to equity, fixed income, and distressed debt markets through real estate investments over the next decade. 2) Potential to reduce the Company's historical discount to net asset value. 3) Opportunity to take advantage of the current dislocation in the commercial real estate markets. 4) Potential to position the Company's assets to earn greater income for the Company in a historically low interest rate environment.

On January 8, 2021, NHF successfully completed its tender offer to purchase the Company's common shares in exchange for consideration consisting of approximately 20% cash and 80% newly issued 5.50% Series A Cumulative Preferred Shares. The Company purchased 8,750,121 shares at a price of $12.00 per share.

## Portfolio Highlights

Despite the challenges in 2020, we maintain high conviction in the Company's portfolio. In particular, we believe the Company's allocation to opportunistic, durable, and defensive real estate makes it well positioned both in the current environment and over the long term. We believe the real estate sector has the potential to generate the best risk-adjusted return of any sector over the next several years, and the current portfolio composition reflects our constructive outlook in the space.

We recognize that this outlook is not captured in the Company's share price relative to its NAV. The Company has been trading at a significant discount, which significantly widened in the first quarter. We believe the Company's trading value is a result of factors that existed prior to the pandemic (described more below); the issues plaguing the markets in Q1 only added to those challenges.

As of December 31, 2020, over sixty-six percent of the portfolio was invested in real estate. NexPoint's real estate team has continued to drive growth at the firm and has completed more than $11 billion in gross real estate transactions since inception in 2012. The team invests across multiple property types, with experience in multifamily, single-family rentals, office, self-storage, life sciences, and hospitality, among other areas. Our real estate investment capabilities include debt, equity, agency mortgage-backed securities ("MBS"), direct origination, structured credit/preferred, and opportunistic and tax advantaged transactions. Our real estate investments are held in a number of funds and investment vehicles across our platform. The following provides information on the Company's top real estate holdings:

The Company's largest holding is NexPoint Real Estate Opportunities, LLC ("NREO"), a wholly owned REIT comprised of direct real estate investments. These include investments in self-storage and single-family rentals, which we believe are well-positioned in today's environment, as well as an office property that we believe represents long-term potential.

NREO owns an interest in VineBrook Homes Trust, Inc. ("VineBrook") a nontraded REIT advised by NexPoint. VineBrook Homes, LLC (the manager) owns and operates a portfolio of approximately 14,000 single-family rental ("SFR") homes in 19 markets across the Midwest, Heartland, and Southeast The average monthly rent is approximately $1,000, providing affordable, safe, and clean homes for the workforce demographic. The SFR space is among the areas of real estate that has performed well during the pandemic.

Cityplace Tower ("Cityplace") is a 42-story, 1.35 million-square-foot, trophy office building acquired in 2018. The building is adjacent to the Uptown submarket in Dallas, Texas. The prior owners were unwilling to invest significant capital to keep up with the property's competitive set. For example, due to prior ownership, Cityplace was budgeted to average approximately $14/square foot in triple net lease ("NNN") rent equivalent during 2019. Similar office assets in the Uptown submarket in Dallas are achieving average NNN rents of $30/square foot. Plans include significant capital investments to bring class-A amenities to the property and reposition the asset, providing the potential to achieve higher rental rates in both the office and retail spaces. Since the 2018 acquisition, the property announced plans to establish a 223-key, five-star hotel within the building, operated by InterContinental Hotels Group. The hotel will occupy eight of the building's 42 floors and will contain a restaurant, full bar, and lounge. The hotel is slated to open in early 2023 and is expected to more than double Net Operating Income ("NOI") of the building once stabilized.

The Company's second largest holding is NexPoint Storage Partners ("NSP"). NSP is a nearly $1.1 billion storage platform originating from NexPoint's investments in the publicly traded self-storage REIT Jernigan Capital. Jernigan initially focused on development financing but gradually expanded the business model to include outright ownership of facilities through a complementary acquisition strategy. In November 2020, NexPoint completed the acquisition of Jernigan in a take-private transaction valued at approximately $1 billion and subsequently launched NexPoint Storage Partners as a dedicated platform for the self-storage sector. The platform consists of 69 self storage investments across the US, of which 38 are wholly-owned. NexPoint Storage targets Generation V or "GenV" facilities in major metropolitan areas across the US. GenV facilities are vertical buildings, and include heating/air condition, WiFi, LED lighting and advanced security systems. A key Partner is Extra Space Storage, who will manage all wholly owned facilities and also provided financing in the acquisition.

The Company also has invested in another self-storage company, Safstor, which is held in a wholly owned REIT, NexPoint Real Estate Capital, LLC. SafStor owns, develops, and redevelops single- and multistory self-storage properties in undersupplied markets with high barriers to entry. The company seeks markets that offer low delinquency, high traffic count, and high population growth, with above-average household income. Property management is performed by reputable operators such as Extra Space Storage and CubeSmart. As of December 31, 2020, Safstor has completed seven individual storage facilities that are currently in lease up. An additional 22 projects are in the construction and planning phases, with completions expected through the next two years. The projected weighted average yield on cost is 8.6% for all SafStor properties. Stabilized cap rates for similar properties average approximately 5.0% - 5.5%, reflecting the potential for SafStor properties to see significant increases in value once stabilized. Additionally, we expect appreciation of the storage portfolio once development is complete.

The Company maintains a minimal amount of exposure to Hospitality. NexPoint funded the development of an upscale Marriott hotel in the heart of the Uptown submarket of Dallas, Texas. Upon completion, the hotel will boast 255 upscale guestrooms with approximately 13,000 square feet of meeting space. The hotel aims to fill a void in the immediate submarket, which lacks an affordable, quality hotel for the business traveler. The hotel opened in February 2021. Currently, the only major hotels in the general vicinity are five-star, luxury hotels. The Uptown area of Dallas is known for attracting young professionals, as well as business travelers due to the proximity to the many businesses in Uptown and Downtown. Uptown has a vibrant bar and restaurant scene, as well as a 9-mile walking and biking trail and several large parks. College students at nearby Southern Methodist University are also known to live in the area. Once complete, the hotel will contain high-class amenities built to attract young adults and business travelers alike, such as a rooftop pool lounge, as well as bars and restaurants featuring celebrity chefs. Dallas Love-Field Airport is also less than five miles away.

The Company's investment in Creek Pine Holdings continues to perform well. We originally invested in the asset in May 2018 as a participating preferred investor in a joint venture with a consortium of institutional investors led by Catchmark Timber Trust (ticker: CTT). The asset comprises 1.1 million acres of prime East Texas timberlands. The timberlands are located near top quartile mills and within approximately 100 miles of three of the top five U.S. homebuilding markets; Austin, Dallas, and Houston. These markets provide strong, growing, and compelling demand fundamentals. The joint venture assumes long-term sawtimber and pulpwood supply agreements with Georgia-Pacific and International Paper.

On June 24, 2020, Catchmark announced that the joint venture has amended its wood supply agreement with Georgia Pacific intended to achieve market-based pricing on timber sales. Under the amended supply agreement, the asset will also be able to increase reimbursement for extended haul distances, sell timber to other third parties, and expand its ability to sell large timberland parcels to third party buyers. The supply agreement with Georgia Pacific has also been extended by two years, with optimized harvest volume obligations to enhance and preserve long-term value. Speaking of the transaction, Catchmark CEO, Brian Davis, said "we expect these amendments to increase cash flows from timber sales at market-based prices based on customary pricing mechanisms, improve the value and marketability of the property for the long-term, and significantly enhanced the investments ability to make opportunistic timberland sales as well as recapitalize our investment." John Rasor at Catchmark added "our operations can now realize the full potential of the investments premier timberland holdings to optimize future cash flow and value." The Amended and Restated Joint Venture Agreement further provides for an increase in the 10.25% cumulative return on the preferred investors' interests in Triple T's subsidiary real estate investment trust of 0.5% per quarter, subject to a maximum increase of 2.0% and subject to decrease in other circumstances. This is very positive news and renegotiation of this agreement has been central to our investment thesis.

On February 11, 2020, as part of the formation transaction for NexPoint Real Estate Finance (NYSE:NREF), certain assets held in NHF, were contributed in exchange for operating partnership units of NREF. The NREF OP Units are convertible one-to-one for NREF Common shares and therefore are priced daily. NexPoint Real Estate Finance is a publicly traded mortgage REIT listed on the New York Stock Exchange under the symbol "NREF". The company primarily concentrates on investments in real estate sectors where its senior management team has operating expertise, including multifamily, SFR, and self-storage, predominantly in the top 50 metropolitan statistical areas. The company focuses on lending or investing in properties that are stabilized or have a "lighttransitional" business plan.

## The Company's Strategy

The NexPoint Strategic Opportunities Fund (NYSE:NHF) ("NHF" or the "Company") is a closed-end investment company managed by NexPoint Advisors, L.P. that is in the process of converting to a diversified REIT. On August 28, 2020, shareholders approved the Conversion proposal and amended the Company's fundamental investment policies and restrictions to permit the Company to pursue its new business. The Company is in the process of realigning its portfolio so that it is no longer an "investment company "under the Investment Company Act of 1940 (the "1940 Act") and continues to expect the Company to be able to transition its investment portfolio sufficient to qualify as a REIT for tax purposes by the first quarter of 2021 and to apply to the Securities and Exchange Commission (the "SEC") for an order under the 1940 Act declaring that the Company has ceased to be an investment company (the "Deregistration Order") in the first half of 2021.

## Annualized Returns (%) as of 12/31/2020

| | YTD | 1-Year | 3-Year | 5-Year | 10-Year |
|---|---|---|---|---|---|
| NHF Market Price | -33.46 | -33.46 | -15.14 | -0.13 | 4.69 |
| NHF NAV | -12.52 | -12.52 | -3.57 | 5.02 | 8.27 |
| **MARKET INDICES** | | | | | |
| DJCS Hedge Fund Index[1] | 6.34 | 6.34 | 4.01 | 4.06 | 3.81 |
| HFRX Global Hedge Fund Index[1] | 6.79 | 6.79 | 2.66 | 3.29 | 1.26 |

***The performance data quoted here represents past performance and is no guarantee of future results. Investment returns and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For performance data current to the most recent month-end, please call 877-665-1287.***

# Disclosures

***Before investing in the Fund, you should carefully consider the Fund's investment objectives, risks, charges and expenses. For a copy of a prospectus which contains this and other information, please visit our website at www.nexpoint.com or call 1-866-351-4440. Please read the fund prospectus carefully before investing.***

The information herein has been prepared by the Investment Adviser, is based upon unaudited information, and has not been independently audited or verified. This summary is for informational purposes only and is subject to change.

Past performance is no guarantee of future results. The rate of return will vary and the principal value of an investment will fluctuate and shares, if sold, may be worth more or less than their original cost. current performance may be lower or higher than the performance data quoted. Returns are historical and include change in share price and reinvestment of all distributions. Total investment return does not reflect broker sales charges or commissions. All performance information is for common shares of the Trust. See the prospectus and financial statements for more information before investing.

Portfolio and industry composition may change with market conditions. The Fund's portfolio holdings are subject to change without notice. The mention of specific securities is not a recommendation or solicitation for any person to buy, sell or hold any particular security.

Shares of closed-end funds frequently trade at a discount to their net asset value. Because of this possibility and the recognition that any such discount may not be in the interest of shareholders, the Board might consider from time to time engaging in open-market repurchases tender offers for shares or other programs intended to reduce the discount.

The distribution may include a return of capital. Please refer to the Source of Distribution on the NexPoint Advisors website for Section 19 notices that provide estimated amounts and sources of the Company's distributions, which should not be relied upon for tax reporting purposes.

While NexPoint is committed to the REIT conversion, it is still contingent upon regulatory approval and the ability to reconfigure NHF's portfolio to attain REIT status and deregister as an investment company. The time required to reconfigure the Company's portfolio could be impacted by, among other things, the COVID-19 pandemic and related market volatility, determinations to preserve capital, the Company's ability to identify and execute on desirable investments, and applicable regulatory, lender and governance requirements. The conversion process could take up to 24 months; and there can be no assurance that conversion of NHF to REIT status will improve its performance or reduce the discount to NAV. Further, the SEC may determine not to grant the Company's request for the Deregistration Order, which would materially change the Company's plans for its business and investments.

In addition, these actions may adversely affect the Company's financial condition, yield on investment, results of operations, cash flow, per share trading price of our common shares and ability to satisfy debt service obligations, if any, and to make cash distributions to shareholders. Whether the Company remains a registered investment company or converts to a REIT, its common shares, like an investment in any other public company, are subject to investment risk, including the possible loss of investment. For a discussion of certain other risks relating to the proposed conversion to a REIT, see "Implementation of the Business Change Proposal and Related Risks" in the proxy statement.

No assurance can be given that the Company will achieve its investment objectives.

**Closed-End Fund Risk.** The Company is a closed-end investment company designed primarily for long-term investors and not as a trading vehicle. No assurance can be given that a shareholder will be able to sell his or her shares on the NYSE when he or she chooses to do so, and no assurance can be given as to the price at which any such sale may be effected. **Credit Risk.** Investments rated below investment grade are commonly referred to as high-yield, high risk or "junk debt." They are regarded as predominantly speculative with respect to the issuing company's continuing ability to meet principal and/or interest payments. Non-payment of scheduled interest and/or principal would result in a reduction of income to the Company, a reduction in the value of the asset experiencing non-payment and a potential decrease in NAV of the Company. **Interest Rate Risk.** Interest rate risk is the risk that debt securities, and the Company's net assets, may decline in value because of changes in interest rates. Generally, fixed rate debt securities will decrease in value when interest rates rise and increase in value when interest rates decline. **Leverage Risk.** The Company uses leverage through borrowings from notes and a credit facility, and may also use leverage through the issuances of preferred shares. The use of leverage magnifies both the favorable and unfavorable effects of price movements in the investments made by the Company. Insofar as the Company employs leverage in its investment operations, the Company will be subject to substantial risks of loss. **Industry Concentration Risk.** The Company must invest at least 25% of the value of its total assets at the time of purchase in securities of issuers conducting their principal business activities in the real estate industry. The Company may be subject to greater market fluctuations than a fund that does not concentrate its investments in a particular industry. Financial, economic, business, and

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other developments affecting issuers in the real estate industry will have a greater effect on the Company, and if securities of the real estate industry fall out of favor, the Company could underperform, or its NAV may be more volatile than, funds that have greater industry diversification. **Real Estate Risk.** Real estate investments are subject to various risk factors. Generally, real estate investments could be adversely affected by a recession or general economic downturn where the properties are located. The full extent of the impact and effects of the recent outbreak of COVID-19 on the future financial performance of the Company, and specifically, on its investments and tenants to properties held by its REIT subsidiaries, are uncertain at this time. The outbreak could have a continued adverse impact on economic and market conditions and trigger a period of global economic slowdown.

The COVID-19 pandemic and governmental responses thereto have severely negatively affected the real estate industry in general. The imposition of "shelter-in-place" orders for certain businesses have led to a dramatic reduction in demand for office and retail space. As many businesses have been required to operate through remote working programs, their current need for office space has been significantly reduced. Other businesses, including restaurants, entertainment venues and retail businesses, have been prohibited from keeping their doors open to customers and required to limit services to takeout, delivery, and e-commerce. Such prohibitions have limited demand for retail space. Although a majority of states have announced plans to permit a phased re-opening of businesses in certain sectors, and the Company expects that social distancing requirements may require such businesses to use more space in the near term to perform existing functions, public health concerns about large gatherings and use of public spaces and the impact of working remotely and on-line purchasing may lead to a reduction in corporate and retail space requirements in the long term, resulting in reduced construction and higher vacancy rates, as well as bankruptcies and insolvencies of clients and counterparties, higher foreclosure rates and declines in real estate values and transaction volumes.

Most market observers believe that the global economy is currently in the midst of a recession. During economic recessions, real estate values typically decline, sometimes significantly. Declining real estate values may increase the likelihood that borrowers will default on their debt service obligations and that lenders will incur losses as a result because the value of the collateral that secures such loans may then be less than the debt owed plus costs of recovery. In addition, some tenants have been, and may in the future be, required to suspend operations at properties owned by us or in which the Company invests for extended periods of time. Tenants may request rent concessions and more tenants may request rent concessions or may not pay rent in the future. This could lead to increased rent delinquencies and/or defaults under leases, a lower demand for rentable space leading to increased concessions or lower occupancy, increased tenant improvement capital expenditures, or reduced rental rates to maintain occupancies.

Further, the Company may be limited in its ability to access capital and, as a result, the Company would have limited capital to invest. The long-term impact of the COVID-19 pandemic and its aftermath on financial markets is uncertain. To the extent that impact is sustained for an extended period, the Company expects that it will be further challenged in accessing capital. As a result, the Company's ability to grow its business and investment portfolio may be limited for an indefinite period.

The Company believes that the risks associated with its investments will increase during periods of economic slowdown or recession, especially if these periods are accompanied by declining real estate values. Consequently, the Company's investment strategy may be adversely affected by a prolonged economic downturn or recession related to the COVID-19 pandemic, which could adversely affect the Company's ability to pay distributions on the Common Shares, the Company's ability to repay or refinance its existing indebtedness, and the price of the Common Shares.

**Illiquidity of Investments Risk.** The investments made by the Company may be illiquid, and consequently the Company may not be able to sell such investments at prices that reflect the Investment Adviser's assessment of their value or the amount originally paid for such investments by the Company.

Prepared by NexPointAdvisors, L.P