



# The Time Is Now for LGPS to Capitalise on European Real Estate Debt

*Room151* sits down with Richard Howe, co-head and managing director, Fiera European Real Estate Debt Strategies, to discuss how rising rates and the retreat of bank lending has created an attractive opportunity for investors.

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## How has the retreat of bank lending to the European real estate market made real estate lending a more attractive opportunity for institutional investors?

Since the global financial crisis, banks have faced mounting regulatory constraints, prompting a retrenchment from real estate lending. This gap in funding has been filled in part by alternative debt funds, with real estate debt emerging as a recognised asset class in the investor community.

The surge in demand for alternative financing has enabled institutional investors to step in and capitalise on higher returns

compared to traditional fixed-income investments. Additionally, the acceptance and preference for private real estate debt as a financing source has paved the way for private credit funds to extend loans to leading sponsor groups, secured against top-tier real estate assets.

Investing in real estate debt offers institutional investors an opportunity to diversify portfolios beyond conventional assets. It has the potential to provide attractive risk-adjusted returns, alongside a secure and predictable income stream to enable liability matching. The downside protection offered through structuring and underwriting risk can also reduce overall portfolio risk. Lastly, the hard asset security appeals to LGPS investors looking to explore other ways to invest in real estate with security over the asset.



## European real estate is already facing a funding gap, how has this been impacted by rising interest rates?

The rise in interest rates and consequent increase in the risk-free rates has led to a decline in property valuations, ranging from 20% to 40% depending on the asset class.

This decline has prompted mainstream lenders to focus on managing their existing portfolios, resulting in reduced activity in originating new loans. In addition, the competition from the banks has reduced partly due to restrictions they face imposed by interest cover ratio requirements, which limit the loan-to-value ratios such lenders can offer.

During this period, alternative credit funds have stepped in to fill the void left by traditional lenders. Such funds are typically able to offer more innovative solutions and have been able to capitalise on opportunities that would typically have been financed by the core lenders. As a result, debt funds, such as Fiera's European Real Estate Debt Strategy, can achieve superior risk-adjusted returns for their investors.

Many LGPS investors are currently enjoying very healthy funding ratios as a result of rising rates. They are now on the lookout for strategies which offer predictable secure income. With their long-term investment horizon, real estate debt strategies can play a vital role addressing this funding gap whilst also offering a reliable source of income.

## What do rising rates mean for the refinancing of new debt?

More muted activity from the banks certainly plays into the hands of private credit funds who aren't constrained by the same restrictive regulatory regime. However, new acquisition

and development transaction volumes in 2023 were down in region of 60% as borrowers focused on their existing portfolios. Alongside this, a widening in the bid-ask-spread caused a slowdown in new acquisition activity.

Conversely, refinancing volumes were much higher as borrowers were looking to find alternative capital solutions. Whilst this presents several attractive opportunities, we also reviewed a large number of broken capital structures that were compromised absent additional equity being invested by an underlying borrower. We believe in playing very selectively in the refinancing space, whereby we back fundamentally good property owned by strong sponsor groups with clear pathways to add value and thus de-risk our debt position.

## Many LGPS investors tend to be focused on UK real estate, what does the European market have to offer from a lending perspective?

Lending into select European countries has the most scope for growth for several reasons. One consideration is that the private debt market on the continent is relatively less advanced versus its UK and US counterparts. Consequently, borrowers often seek overseas capital partners due to regulatory hurdles and limited domestic options in local markets.

European real estate can also play a crucial role in offering LGPS investors greater portfolio diversification.

Expanding our market share in select European regions allies with our long-term investment strategy. In line with this objective, we recently closed our inaugural deal in Spain – a senior debt construction facility supporting the ground-up development of a Purpose-Built Student Accommodation (PBSA) scheme near the main university campus in Alicante. We are excited about backing this project, recognising the increasing demand for high-quality student accommodation in a very supply starved market.

## How are you integrating climate / carbon reduction targets into your investment strategy?

The Fiera European Real Estate Debt strategy is classified as an Article 8 strategy under SFDR regulations and also has a net zero carbon target of 2035 across scope 1, 2 and 3 emissions. In order to meet these requirements and targets, we have a proprietary sustainable lending framework that we require our prospective borrowers to satisfy as part of our due diligence processes. This framework assesses both the borrower and real estate project's (whether refurb, existing or new development) commitment toward sustainability and ESG considerations, including climate risk and carbon reduction. Allocating to our debt strategy could help LGPS in setting and achieving their own net zero targets.

## What is the structure of the strategy and what returns can investors achieve?

Our strategy is predominantly focused on senior secured lending because that is where we see the most compelling risk adjusted returns, particularly in the current macroeconomic environment. We are targeting returns of 9-11% IRR for those invested in the strategy.

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