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Real Estate Debt Whitepaper

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Welcome to CAMRADATA's Real Estate Debt Whitepaper

After a brutal period of returns, many real estate managers are more optimistic about the years ahead. One of the immediate causes of the hurt, fast-rising interest rates, now supports their hope. Debt is offering juicier returns because base rates are five per cent higher than the start of the decade. Those higher rates, however, bring to the fore the skill of stockpicking.

Not every owner of real estate has been able to cope with the extra costs of financing (just as not every owner or landlord is strident in greening their property). There have been blow-ups in real estate that have wiped out profits for both European and US lenders. Some of these crises have specific causes other than rising rates. The regional banking crisis in the US is one such cause. COVID's legacy of Working From Home is another (Shopping From Home is a longer-running trend that COVID also deepened).

Whatever the combination of causes, it is not contradictory to argue that while stockpickers can select the best real estate deals for their portfolios, the challenges for struggling sectors and regions will continue for years.

Pension funds and other long-term investors may be optimistic, given that their fund managers can pick up deals, notably in CRE, from stressed banks. It is evidently a trend for banks to reduce their books in order to comply with regulatory solvency demands.

Nevertheless, it is not clear that banks will be willing to let go of their best-performing portfolios simply because those are what alternative financiers wish for.

Meet the Team



Natasha Silva
Managing Director,
Client Relations



Amy Richardson
Managing Director,
Business Development



Orin Ferguson
Associate, Business
Development



Sarah Northwood
Marketing and Events
Coordinator



Dorota Madajczyk
Senior Associate, CRM &
Circulation Administrator

Real Estate Debt Roundtable

The CAMRADATA Real Estate Debt Roundtable took place in April 2024

Discussions at the CAMRADATA Real Estate Debt roundtable of April 2024 began with the longstanding dilemma of where real estate debt sits within asset owners' strategic asset allocation. Nemashe Sivayogan, head of Treasury and pensions at the London Borough of Merton, asked the panel whether real estate debt is completely different to private debt. The Merton pension fund currently has 6.5% of assets in private debt and 5% in real estate equity. It is looking for more long-term income streams to meet its cashflow requirements.

Alice Wilcox, EMEA co-head of real estate alternative capital formation at Goldman Sachs Asset Management, replied that real estate credit can be floating rate, short duration and directly originated. It has covenants, access to collateral and can provide diversification benefits to a portfolio.

Pierre Saëli, head of real estate loans at SCOR Investment Partners, agreed, noting that recovery rates were higher, on average, in real estate debt than private debt. From another perspective, David Renshaw, co-head of Fiera Real Estate Debt Strategies (Europe), said that real estate equity and real estate debt were weakly correlated. He pointed out how inflation had knocked back equity values last year where debt had done well. "At some point in the cycle, equity will once again outperform," said Renshaw. But given the unusual period of low interest rates up to the start of this decade, he did not expect that point to be reached in the next 18 months.

Falling values may have hurt real estate equity but returns for real estate debt have been great: 300-350 bps above Euribor at the end of 2023, according to Saëli.

This, coupled with the significant benefit provided by increasing base rates in 2023 meant that many equity investors were now beginning to look at debt.

When it comes to strategic returns from real estate debt more generally, Tom Goodwin, lead specialist

in the real estate investment team at Mercer, said that there was broad choice available for investors. He explained that much depended on how close to the equity, lenders want to be. At the safer end of the spectrum was super senior. As Loans-to-Value (LTVs) increased, and if lenders took options such as subordinated structures, preferred equity, or equity-like return kickers based on exit values, then the return profile changed accordingly.

Incepted in April 2023, Fiera's European real estate debt strategy advances development and value-add funding, targeting a net investor return of 10%. The average loan duration is 2-3 years and average Loan to Gross Development Value is circa. 60% meaning that there is significant equity subordination on any deal.



“From a borrower’s perspective, dealing with a single lender providing a one-stop whole loan solution (which may or may not be enhanced through the use of back-leverage) is simpler than adding mezzanine finance and working with both senior and junior lenders. It may also be cheaper.”



Renshaw said that the Fiera strategy concentrates on bilaterally originated senior whole loans, which meant that there were just two parties in the deal. Agreements were bespoke, tailored to each property with Fiera as sole lender having full control and bespoke, tailored covenants.

In these times when equity values have fallen while the cost of borrowing has risen, Renshaw said that power has shifted towards lenders in agreeing terms.

He explained that if a loan became non-performing, then there is an enforcement plan, although that is a last resort. Fiera's focus is on working with best-in-class borrowers with demonstrable track records in their given sectors. These borrowers will always have significant skin in the game in terms of cash equity invested and as a result, interests are inherently aligned and any problem positions will initially be tackled on a consensual basis. "But you will always have a plan," he underlined.

Saëli said that for SCOR Investment Partners, enforcement is only when the deal has completely gone wrong, ie the sponsor gives back the keys. But far more likely is a potential covenant breach. In those situations, borrower and lender are going to negotiate. Saëli noted that banks as creditors do not want to take back keys. Asset managers, however, often have the capability and desire to do so.

SCOR Investment Partners focuses on senior and mezzanine in the value-add space "where there is even less competition from banks," said Saëli. He added that spreads on core real estate debt in Europe were no more attractive than publicly-traded Investment Grade debt right now, so there was little appeal to that niche of private debt.

Moreover, the recent depreciation of most commercial real estate means that mezzanine is not in strong demand right now either. However lower values

coupled with decreasing leverage mean a financing gap has emerged in Europe. Saëli described the space as interesting now, with deals beginning to look more attractive, especially in sectors such as logistics and with amortization on offer.

Renshaw agreed. The Fiera strategy does not include mezzanine financing but Renshaw predicted outsized returns from this type of lending once the European market bottoms out, probably next year. "So far we have seen a lot of requests for refinancing but not an avalanche," he said. He wasn't sure how much demand had been met by banks extending loans. He did acknowledge backleveraging as a currently popular theme. "It's a way for asset managers to increase returns," he said. "There did not use to be many UK-headquartered funds using back leverage but it has now become a more mainstream product. There are also an increasing number of banks offering back leverage which is an attractive proposition for them, due to favourable structuring and regulatory treatment in addition to the ability to effectively utilise private credit's underwriting and due diligence."

"From a borrower's perspective, dealing with a single lender providing a one-stop whole loan solution (which may or may not be enhanced through the use of back-leverage) is simpler than adding mezzanine finance and working with both senior and junior lenders. It may also be cheaper," added Goodwin.

Sticky inflation

Sivayogan asked about the possibly adverse impact of high interest rates on real estate debt. Wilcox noted that inflation has remained sticky. Real estate debt can be short duration and floating rate. Her observation was that the impact of high rates will likely create a funding gap as loans roll over in the coming years and

there is likely to be continued growth in asset managers supplying real estate debt to the market.

Goodwin agreed that banks would typically concentrate on core loans; insurers would be prepared to take on the next echelon of risk, offering marginally higher LTVs and accepting a degree of letting risk, leaving alternative lenders' involvement predominantly in core+ and complex/value-add deals. In terms of LTVs, he described the first echelon as c.50% LTV secured against stabilised assets, the second as c.60% LTV secured against mostly stabilised assets, and the third as anything falling outside of these parameters, including opportunities with complications such as the need to lease more of the space, opportunities requiring capital expenditure to improve the quality of the assets, or lending above 60% LTV.

Goodwin underlined, however, that the increase in returns is not necessarily proportionately matched by an equivalent rise in risks. "A metaphor I like to use is that alternative lenders predominantly play in the shoreline of the activity of traditional lenders. By providing loans just beyond the parameters of traditional lender appetite, e.g. at a marginally higher LTV, or with more real estate business plan complexity, returns can increase disproportionately relative to the marginal increases in risk," he said.

Mercer's team tracks a set of 40-50 European real estate debt funds and has equivalent coverage in North America. Goodwin described Europe as fragmented and inefficient because of regional and national differences. This makes fertile ground for outsized returns.

Sivayogan said she understood the appeal of determining terms and conditions but asked what happens if a borrower was failing on ESG issues. She queried whether credit has any influence once the deal has been signed.

Saeli replied that because of the nature of value-add, where there will be refurbishment before tenants occupy the building, it is the norm nowadays to make ESG KPIs part of the lending agreement. He added that both tenants and investors these days want their assets to be sustainable and have green credentials. These are much more standardised thanks to universally acknowledged criteria from the likes of BREEAM and LEED. Then there are national mandatory requirements; both France and the UK are demanding higher EPC ratings for rented commercial and residential properties in the years ahead.

"There is a lot of emphasis on ESG," Wilcox said. "Who is the borrower and where has the capital come from?" "Is the building net-zero aligned?" "Where does the energy come from?"

Goodwin said that real estate lending deserves more credit for its ESG influence. With traditional lenders pulling back from financing value-add activity, much of the modernisation and much required ESG improvements of the built environment will likely fall upon alternative lenders to finance.

He recounted one deal where he had been surprised how much input the lender was able to give to the borrower's business plans. "That is measurable thanks to more and more detailed reporting and data transparency," he said.

Saeli said environmental certifications, such as BREEAM, were initially a good proxy for ESG standards. That is still used, but SCOR Investment Partners has developed KPIs, mostly on energy. For refurbishments, the manager targets a 30% reduction in final energy consumption. For new builds, the target is 10% lower than the most stringent regulation. Although it is not a SCOR Investment Partners obligation, the manager also works with some building companies that target re-use of materials from buildings as part of the circular economy.

Saeli recalled that only one time has the manager had to act because of an ESG breach, in this case where targeted energy improvements were not achieved.

For Fiera, Renshaw said it had strong ESG policies in place within a proprietary sustainable lending framework and an inhouse sustainability team. "In the last three years this theme has come on leaps and bounds," he said. "There is now real alignment between debt and equity in terms of embedding ESG improvements in underlying properties as it beneficial to both parties and improves underlying asset exit liquidity as well as well as of course, preserving value."

Goodwin said "Data collection has improved since the pandemic, the sometimes adversarial relationship between tenants and landlords to some degree diminished as temporary rent deferrals were sought by tenants, and the willingness of tenants to share for example energy/water usage data increased."

Anecdotally he had seen instances of portfolio ESG data collection increase from c.30% of a portfolio being collected to c.90%+, following the pandemic.

“

Sivayogan said she understood the appeal of determining terms and conditions but asked what happens if a borrower was failing on ESG issues. She queried whether credit has any influence once the deal has been signed..”

What's the impact?

Sivayogan then asked about Impact investing, which she noted is a key element of investment objectives for Merton pension fund and the other Local Government Pension Schemes too.

Wilcox said that the GIIN framework was a starting place. She suggested that real estate debt could be impactful, for example, if directed towards affordable housing or constructions that improve local job opportunities.

Goodwin noted that investors should be wary of using the EU's Sustainable Finance Disclosure Regulation ("SFDR") as a screening process or proxy for considering whether a strategy has high ESG or Impact capabilities. It can be difficult for strategies targeting a value-add ESG ("brown to green") strategy to achieve SFDR Article 9. Whereas for lenders financing already-green buildings, i.e. with no impact transformation, it would be easier to achieve SFDR Article 9. Most core+/value-add real estate debt funds therefore target SFDR Article 8.

Sivayogan then asked about development finance. She wanted to know what investment opportunities there were in this field in the UK.

"The opportunity set is huge, in particular in repurposing of existing assets into those that are fit

for the future," said Renshaw. "Private credit can play an increasingly influential role in providing a significant proportion of capital needed for impact investing."

The CAMRADATA Real Estate Debt roundtable for 2024 closed with Goodwin's observation that for at least one large set of traditional investors, property debt rather than property equity could offer an interesting opportunity. "As funding levels for UK defined benefit pension plans have improved, and risk/return requirements have reduced, asset allocations have broadly moved away from equity strategies towards debt strategies. This journey down the risk curve has commonly been joined by a move away from illiquid strategies, as pension schemes begin to target insurance-based solutions such as buyout," he said. "However, for schemes not seeking insurance-based solutions in the near-term, or perhaps considering self-sufficiency and therefore able to tolerate a degree of illiquidity, real estate debt may offer compelling risk/return characteristics."

Goodwin reckoned that the market in recent years has evolved, with the introduction of open-ended/semi-open-ended investment structures: "Real estate debt is a tailorable asset class with a broad array of risk, return, and liquidity options available," he concluded.



Roundtable Participants



David Renshaw
Managing Director and Co-Head - Fiera Real Estate
Debt (Europe)

Personal Profile

David joined Fiera Real Estate in September 2022 and is Managing Director and Co-Head of Fiera Real Estate's European Debt Platform.

Prior to joining Fiera Real Estate, David held a senior position in the pan-European real estate debt team at Cheyne Capital where he was responsible for originating new debt investments, underwriting c.€500m of new deals over 24 months and launching the Iberian lending platform.

At Fiera Real Estate, David is responsible for fund management and overall strategy of the debt business, leading on capital raising, governance and portfolio risk management.

Company Profile

Fiera Capital is a leading independent global asset manager investing in both public and private markets. With USD122bn under management and a multijurisdictional model of efficient asset allocation, we construct highly customised multi-asset portfolio solutions in the absolute pursuit of long-term, steady and financially sustainable alpha.

Fiera Capital's European Real Estate division provides direct real estate investment opportunities to institutional investors and high net worth investors and has over a 30-year track record of delivering returns. The business combines an investment management platform and an operating platform through a minority shareholding in nine regional operating partners. Its vertically integrated business model has created a platform of partnerships that allows investors to access some of the best deal flow and entrepreneurial managers within its centralised framework. Fiera Real Estate Debt Strategies have a significant track record of lending into the European real estate market across multiple asset classes and legal jurisdictions.

This solid experience coupled with the Management Teams deep network offer investors the opportunity to secure compelling risk-adjusted returns at conservative leverage positions within the overall capital structure.



Pierre Saeli
Head of Real Estate Loans

Personal Profile

Pierre joined SCOR Investment Partners in October 2022 as Head of Real Estate Loans. He started his career in 1998 as a credit analyst in New York with Crédit Lyonnais Americas.

He then worked for 6 years at Dresdner Kleinwort Wasserstein in M&A in London and New York. In 2005, he joined The Royal Bank of Scotland as a director in the real estate finance department. In 2012, he moved to La Banque Postale Asset Management to start and lead the real estate debt fund business. Pierre graduated from HEC Paris.

Company Profile

SCOR Investment Partners is the portfolio management company of the SCOR Group, a leading global reinsurer. We manage over € 20bn of assets of which € 7.5bn have been entrusted to us by external institutional investors (as of 31.12.2023, undrawn commitments included). Our client base is made up of more than 300 institutional investors from 25 different countries.

We offer investment strategies that focus on diversification, recurring returns, and mitigation of the risk of capital loss. As a responsible portfolio manager, we offer our clients alternative fixed income strategies that meet these objectives and at the same time actively participate in financing the sustainable development of Societies.

We provide our investors access to Insurance-Linked Securities, High Yield Bonds, Corporate Debt, Infrastructure Debt and Real Estate Debt. We have offices in Paris, London, and Zurich.



Roundtable Participants



Alice Wilcox

Managing Director, Co-Head of Real Estate Client Solutions & Capital Markets, EMEA

Personal Profile

Alice is a managing director in the Client Solutions Group within Goldman Sachs Asset Management, serving as EMEA co-head of the Real Estate Client Group. She is responsible for ensuring the firm is committed to developing, growing and maintaining long-term trusted relationships with real estate investors in addition to delivering strong investment performance.

Alice joined the firm in 2022 as a managing director. Prior to joining Goldman Sachs, Alice worked at CBRE Investment Management where she was a member of the European Leadership team and held roles leading the indirect real estate client solutions business globally and having responsibility for CBRE's UK distribution channels. Before that, Alice worked at Schroder Investment Management based in both London and Milan real estate transaction and product teams.

Alice is a member of the European Association for Investors in Non-Listed Real Estate Vehicles, formally serving on the Training and Education Committee and leading the Young Professionals Committee. Alice earned a BA (Hons) in Law and Italian and an MS in Real Estate Finance and Investment from Henley Business School at the University of Reading. She is a Certified Person under the FCA's Senior Managers Certification Regime. Alice has passed the Investment Management Certificate.



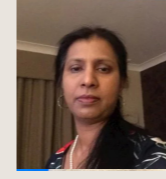
Tom Goodwin

Principal | Lead Specialist | Real Estate - Alternatives at Mercer

Personal Profile

Tom Goodwin is a Principal in the Real Estate Investment Team at Mercer Alternatives and responsible for the investment and research coverage of European and UK real estate strategies, with a focus on long-income and real estate debt.

Since joining Mercer in 2014 he has obtained the IMC and the CFA designation.



Nemashe Sivayogan

Head of Treasury and Pensions

Personal Profile

Nemashe Sivayogan is the Head of Treasury and Pensions at the London Borough of Merton. Nemashe is responsible for looking after the £900m Pension Fund and the Treasury balance of £300m. In addition to Treasury and Pensions, Nemashe also heads the Council's banking, insurance services and is responsible for the year end accounting and auditing of the main Council. Also, she works on a number of projects across the council services.

Nemashe is a qualified Chartered Institute of Management Accountant, holding an associate membership. Nemashe has more than 25 years of experience in accounting and investment management and for the last twenty years she has been working in local government where she specialises in pension fund investment management, accounting and governance.

Nemashe also takes part in the Scheme Advisory Board's Reporting and Compliance committee where she is helping with the accounting and audit issues facing Local Government Pension Funds.

Moderator



Brendan Maton

Freelance Journalist

Personal Profile

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees. He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles.

Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.



Diversity for asset managers is at a critical tipping point.

CAMRADATA now hosts the Asset Owner Diversity Charter within CAMRADATA Live, making it free to access for both asset owners and asset managers alike.

The Asset Owner Diversity Charter was formed with an objective to formalise a set of actions that asset owners can commit to improve diversity, in all forms, across the investment industry. It seeks for signatories to collaborate and build an investment industry which embodies a more balanced representation of diverse societies.

info@camradata.com



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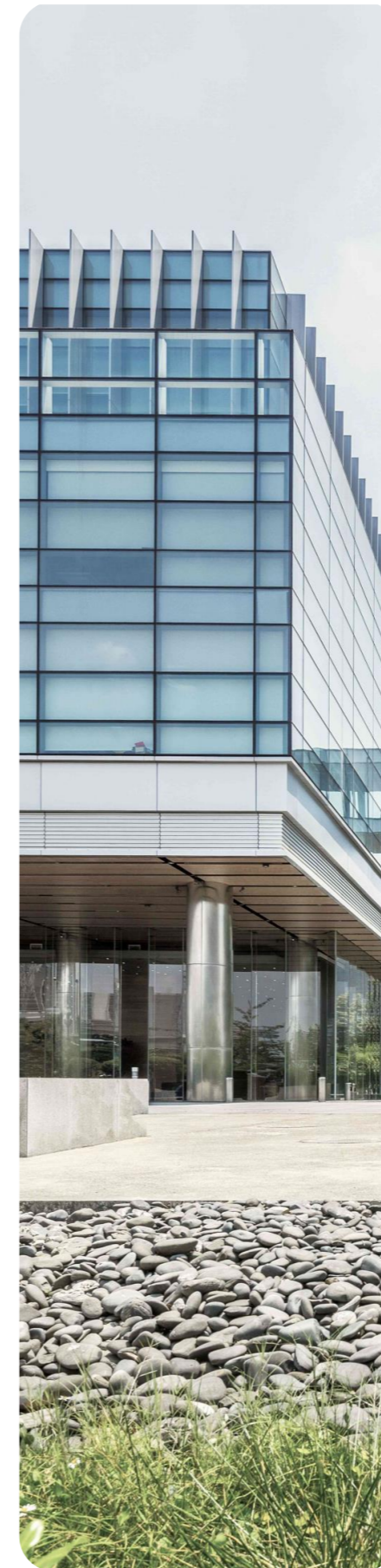
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KEY FIGURES

EUR 2.4bn raised

88 financed projects



Source: SCOR Investment Partners, data as of 31.03.2024

CONTACT

Claire Harding
 charding@scor.com
 +33 6 72 00 12 61

www.scor-ip.com

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CAMRADATA

With Intelligence
One London Wall
London
EC2Y 5EA

+44 (0)20 7832 6500

[camradata.com](https://www.camradata.com)



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