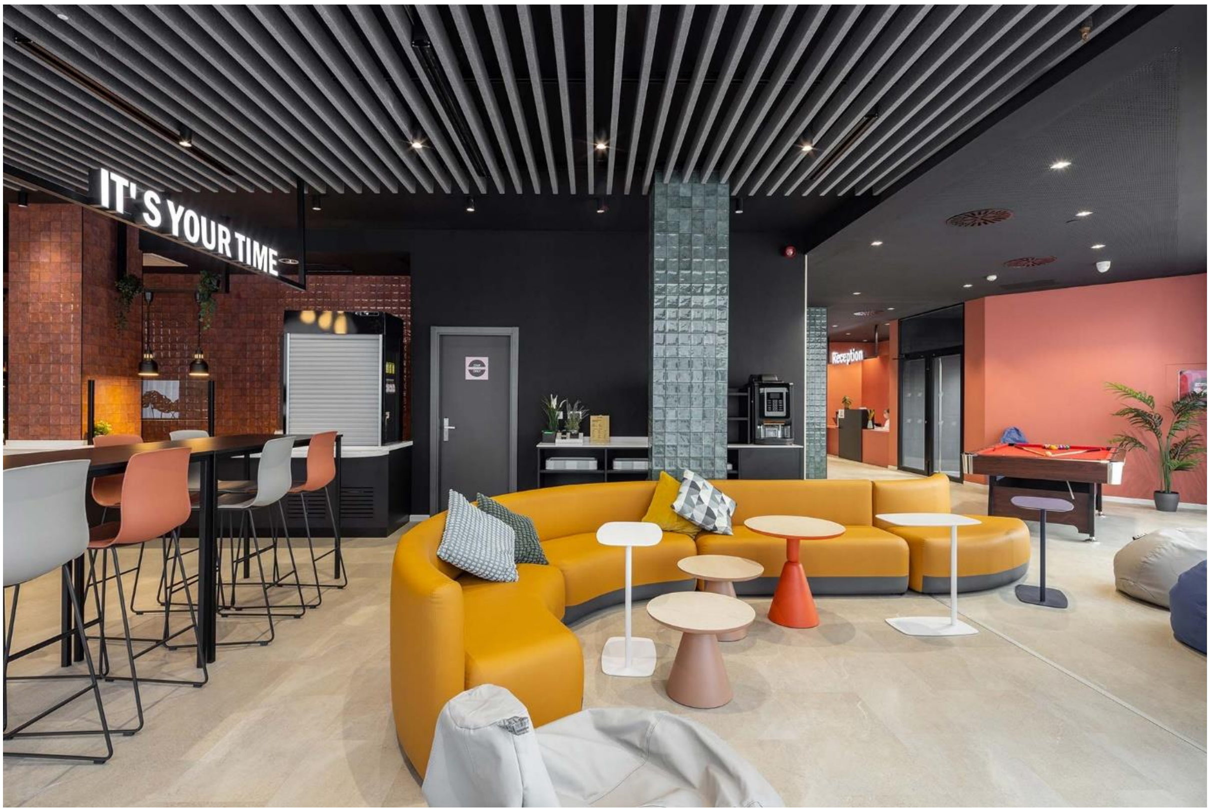
Real Estate Debt: Identifying Opportunities in Market Dislocation

As the global economy continues to grapple with the complexities of inflation and rising interest rates, the real estate debt landscape presents both challenges and opportunities for investors. With the retrenchment of traditional banks from real estate lending, a notable gap has emerged, paving the way for alternative lenders to capitalise on market dislocations. For investors, this means maintaining a flexible approach and seizing opportunities across geographies as well as the capital stack.



Financing the development of 770+ PBSA beds across four Tier 1 university cities in Spain for AMRO Partners has proven to be a defensive investment in a repricing environment.

Market Dislocation

The current economic environment, characterised by high-interest rates and increased capital needs, has given rise to a debt funding gap. Euro area bank lending surveys continue to show further tightening of credit standards across all sectors, and we expect liquidity will continue to be stretched. Although banks have generally been willing to grant extensions, often in exchange for partial paydowns, as paper losses materialise into actual losses, we would expect bank willingness to “extend-and-pretend” to diminish.

Similarly, sponsors have typically been willing to support deals through equity injections, however we do not expect this level of support to be sustainable through the medium-term.

Losses are consequently beginning to appear on the fringes. We are becoming increasingly aware of loans issued in 2018-2020 that are in stress positions resulting in administrations and potential enforcement action across sectors and expect further opportunities throughout 2024. This theme of retrenchment has created fertile ground for non-bank lenders to step in and fill the void.

This situation presents a unique opportunity for investors to engage in refinancing activities as well as debt origination in robust sectors. Driven by macroeconomic themes, those teams with strong off-market capabilities will have doors opened for deals that offer strong risk-adjusted returns.

Investing for Resilience: Logistics & Living

Amidst the challenges faced by traditional real estate sectors, alternative assets have emerged as resilient investment options.

While traditional areas of the market such as offices and retail will remain core allocations in many investor portfolios, alternative asset classes such as student accommodation, self-storage and data centres have grown in popularity as a diversifier, set to benefit from long-term trends and structural advantages.

Self-storage facilities and purpose-built student accommodation (PBSA) are two such sectors that have gained traction, largely due to supply and demand imbalances and the potential to generate attractive returns. An added benefit is these sectors' lack of correlation to global markets, offering insulation from macroeconomic headwinds and therefore reducing the volatility of returns.

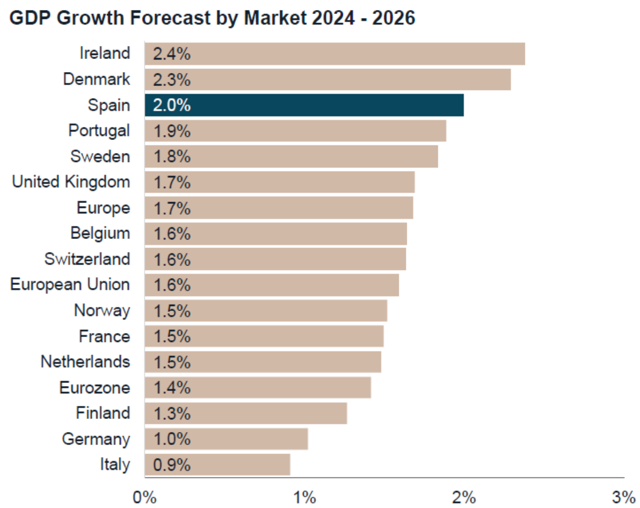
Liquidity for industrial properties remains high, driven by substantial repayments from property sales, particularly in Spain.

Self-storage facilities have become increasingly popular as urbanisation and lifestyle changes drive demand for additional storage space. With limited supply and growing demand, this sector offers compelling opportunities for investors seeking stable cash flows and capital appreciation.

Similarly, PBSA continues to attract institutional capital due to the steady influx of students seeking quality housing options. The resilience of the student housing market, coupled with the vibrant education sector in many European countries, makes PBSA an appealing investment avenue.

Adjusting to Geographic Trends

Successful investors take heed of the distinctive characteristics of each European market and use them to their advantage. For example, Spain is benefiting from robust economic fundamentals and a mature institutional market. We believe that relative to other European markets, Spain is an attractive jurisdiction for direct real estate lending investments. The country's GDP is expected to grow by 2% annually from 2024 to 2026, outpacing many of its European counterparts. At the same time, the economy has withstood the inflationary pressures which have plagued other countries, with 2023 only seeing a 3.4% rise in prices, significantly lower than the UK (7.7%) and Germany (6.3%).



Sources:IMF

This economic resilience, coupled with a lender-friendly legal framework, has produced an increasingly mature investment market with nearly 70% of deals driven by institutional investors from 2020 to H1 2024. Additionally, many segments including PBSA and granular residential assets lack competition from traditional lenders, even with quality sponsors and reasonable LTVs, presenting further opportunities for alternative providers of finance.

The team has deployed over €4.5 billion of capital in European real estate debt over the past 10 years across 8 vehicles on c.100 transactions, consistently exceeding return targets. In Spain alone, we have deployed over €365 million since 2020, including four deals closed in Spanish PBSA and €160 million in Spanish logistics space. As the real estate debt landscape continues to evolve, investors must continue to adapt as they navigate the complexities of market dislocation and aim to capitalise on alternative assets. We believe that looking to those sectors with strong fundamentals, insulated to wider economic trends, in geographies supported by demographic tailwinds, will provide attractive risk-adjusted returns as the real estate market continues to recover.